CLERK'S COPY.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1941

No. 503

PALM SPRINGS HOLDING CORPORATION,
PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 11, 1941.

CERTIORARI GRANTED OCTOBER 13, 1941.

No. 9661

United States

Circuit Court of Appeals

For the Ninth Circuit.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

PALM SPRINGS HOLDING CORPORATION,
Respondent,

and

PALM SPRINGS HOLDING CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the United States Board of Tax Appeals.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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Docket No. 95262

APPEARANCES:

For Taxpayer:
FRANK MERGENTHALER, Esq.

For Comm'r:
E. A. TONJES, Esq.,
FRANK T. HORNER, Esq.,
E. M. WOOLF, Esq.

PALM SPRINGS HOLDING CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1938

Aug. 29—Petition received and filed. Taxpayer notified. (Fee paid).

Aug. 29—Copy of petition served on General Counsel.

Aug. 29—Request for circuit hearing in Los Angeles, California, filed by taxpayer. 8/29/38 copy served.

Oct. 13—Answer filed by General Counsel.

Oct. 15—Copy of answer served on taxpayer. Los Angeles, Calif.

1939

July 11—Hearing set Sept. 18, 1939, Los Angeles, California.

1939

Sept. 27—Hearing had before Mr. Kern on the merits. Submitted. Stipulation of facts filed. Briefs due Dec. 1, 1939. Reply briefs due Dec. 26, 1939.

Oct. 23—Transcript of hearing of 9/27/39 filed.

Nov. 29—Brief filed by taxpayer. 12/2/39 copy served on General Counsel.

Dec. 1—Brief filed by General Counsel.

Dec. 23—Reply brief filed by taxpayer.

1940.

Mar. 23—Memorandum findings of fact and opinion rendered, John W. Kern, Div. 16. Decision will be entered under Rule 50.

Apr. 16—Computation of deficiency filed by General Counsel.

Apr. 18—Hearing set May 22, 1940 on settlement.

May 22—Hearing had before Mr. Arundell on settlement under Rule 50. Respondent's recomputation not contested. Referred to Mr. Kern for decision.

May 25—Decision entered, John W. Kern, Div. 16.

Aug. 10—Petition for review by United States Circuit Court of Appeals, Ninth Circuit; with assignments of error filed by General Counsel.

Aug. 20—Proof of service filed by General Counsel. (2)

Aug. 22—Statement of points filed by General Counsel, with proof of service thereon.

1940

Aug. 22—Agreed designation of portions of the record to be printed, filed by General Counsel.

Aug. 22—Agreed designation of portions of record filed (General Counsel), with proof of service thereon. [1*]

Aug. 22—Petition for review by United States Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.

Aug. 22—Proof of service filed by taxpayer.

Sept. 5—Statement of points filed by taxpayer, with proof of service thereon.

Sept. 5—Agreed designation of portions of the record to be printed filed by taxpayer.

Sept. 5—Agreed designations of portions of record filed by taxpayer, with proof of service thereon.

Sept. 16—Certified copy of order from the 9th Circuit that the proceedings be consolidated for briefing, hearing, argument and decision upon a single consolidated transcript of record, consisting of such portions of the record made before the United States Board of Tax Appeals as the parties herein may indicate by their designations, omitting any repetition of documents, filed.

Sept. 16—Certified copy of order from the 9th Circuit extending the time to Oct. 19, 1940 to transmit the record, filed. [2]

*Page numbering appearing at foot of page of original certified Transcript of Record.

United States Board of Tax Appeals

Docket No. 95262

PALM SPRINGS HOLDING CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue, in his Notice of Deficiency (IT:LA, FHG-90D) dated June 1, 1938, and as a basis of this proceeding, alleges as follows:—

1st. That the petitioner is a corporation, organized and existing under the laws of the State of California, with its principal office at the El Mirador Hotel, Palm Springs, California.

2nd. That the petitioner filed its Federal Income and Excess-Profits Tax Return for the fiscal year ended May 31, 1936, with the Collector of Internal Revenue for the Sixth District of California.

3rd. A Notice of Deficiency, a copy of which is attached and marked "Exhibit A", was presumably [3] mailed to the petitioner on Jupe 1, 1938.

4th. A copy of the report of Internal Revenue agent referred to in the above mentioned Notice of Deficiency is attached hereto and marked "Exhibit B".

5th. The taxes in controversy are income and excess-profits taxes for the fiscal year ended May 31, 1936 as follows:

Income taxes	$6,323.54
Excess-Profits Taxes	940.63
	$7,264.17

Assignment of Error

6th. The Commissioner erred in refusing to allow as a deduction for the fiscal year ended May 31, 1936, depreciation of buildings amounting to $34,442.12.

7th. The Commissioner erred in refusing to allow as a deduction for the fiscal year ended May 31, 1936, depreciation of furniture and fixtures amounting to $16,190.60.

Statement of Fact

8th. Petitioner computed depreciation of its buildings and furniture and fixtures using as a base the cost of the various assets to the original [4] owner. The assets were acquired through a non-taxable reorganization.

9th. Wherefore, the petitioner prays that the Board may hear the proceeding, and that,

(a) It be determined that the Commissioner erroneously disallowed as deductions from income the amounts of $34,442.12 and $16,190.60 representing depreciation of buildings and furniture and fixtures for the fiscal year ended May 31, 1936.

(b) It be determined that there is no deficiency

in the petitioner's income and excess-profits tax liability for the fiscal year ended May 31, 1936.

G. C. CARLSON and
FRANK MERGENTHALER,
By FRANK MERGENTHALER
Counsel for Petitioner,
Room 1110, 548 So. Spring St.,
Los Angeles, California [5]

State of California
County of Los Angeles—ss.

R. F. Ingold being duly sworn according to law, says that he is the Vice President of the above named Palm Springs Holding Corporation, petitioner herein; that he has read the foregoing petition or had the same read to him, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information or belief, and those facts he believes to be true.

R. F. INGOLD

Subscribed and sworn to before me this 24 day of August, 1938.

(Seal) IRMA HARRIS
Notary Public in and for the County of Los Angeles, State of California.

My commission expired Apr. 27, 1942.

I hereby certify that the foregoing is a true copy of the petition to the United States Board of Tax Appeals, signed by me on August 22, 1938.

FRANK MERGENTHALER
Counsel for Petitioner. [6]

EXHIBIT A

SN-R

Treasury Department
Internal Revenue Service
939 South Broadway
Los Angeles, Calif.
Jun. 1, 1938

Office of
Internal Revenue Agent in Charge
Los Angeles Division
IT:LA
FHG-90D
Palm Springs Holding Corporation,
El Mirador Hotel,
Palm Springs, California.
Sirs:

You are advised that the determination of your income tax liability for the taxable year(x) ended May 31, 1936, discloses a deficiency of $6,323.54, and that the determination of your excess-profits tax liability for the year(x) mentioned discloses a deficiency of $940.63, as shown in the statement attached.

In accordance with section 272(a) of the Revenue Act of 1934, notice is hereby given of the deficiencies mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiencies above stated.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward

it to the Internal Revenue Agent in Charge, 939 South Broadway, Los Angeles, California. The signing and filing of this form will expedite the closing of your return(x) by permitting an early assessment of the deficiencies, and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,
GUY T. HELVERING,
Commissioner.
By GEORGE D. MARTIN
Internal Revenue Agent in Charge

Enclosures:
Statement
Form 870 [7]

STATEMENT

IT:LA
FHG:90-D

Palm Springs Holding Corporation,
El Mirador Hotel,
Palm Springs, California.
Tax Liability for Taxable Year Ended
May 31, 1936

	Tax Liability	Tax Assessed	Deficiency
Income tax	$6,323.54	None	$6,323.54
Excess-profits tax	940.63	None	940.63

In making this determination of your income tax and excess-profits tax liabilities, careful consideration has been given to the internal revenue agent's report dated March 19, 1938.

The records of this office indicate that no reply has been received to letter dated May 3, 1938, again calling attention to your right to file a protest in this office and advising you that, in the event a consideration of any such protest filed by you did not result in agreement on the disputed issues, you would be privileged to request that your case be considered by the Los Angeles Division of the Technical Staff.

ADJUSTMENTS TO NET INCOME

Taxable Year Ended May 31, 1936

Net Loss as disclosed by your return		($4,643.31)
Unallowable deductions:		
(a) Excessive depreciation on buildings	$34,442.12	
(b) Excessive depreciation on furniture and fixtures	16,190.60	
Total adjustment		50,632.72
Net income as adjusted		$45,989.41

[8]

EXPLANATION OF ADJUSTMENTS

(a) Excessive depreciation on buildings:

Cost of buildings to May 31, 1935	$321,314.98	
Estimated life 20 years; annual depreciation		$16,065.75
Additions during taxable year	49,640.34	
Depreciation on additions, 5% for 7 months		1,447.85
Allowable depreciation on buildings		$17,513.60
Depreciation on buildings claimed		51,955.72
Excessive depreciation		$34,442.12

(b) Excessive depreciation on furniture and fixtures:

Cost of furniture and fixtures to May 31, 1935	$126,774.21	
Estimated life 8⅓ years; annual depreciation		$15,212.90
Additions during taxable year	11,334.46	
Depreciation on additions at 12%		680.07
Total allowable depreciation		$15,892.97
Depreciation on furniture and fixtures claimed		32,083.57
Excessive depreciation		$16,190.60

[9]

COMPUTATION OF TAX

Taxable Year Ended May 31, 1936

INCOME TAX

Net income as adjusted	$45,989.41
Income tax at 13¾%	$ 6,323.54
Income Tax Assessed:	
Original, account No. 859605	None
Deficiency of income tax	$ 6,323.54

EXCESS-PROFITS TAX

Net income as adjusted	$45,989.41
Less: 12½% of $217,414.11 declared value of capital stock, June 30, 1935	27,176.76
Balance subject to excess-profits tax	$18,812.65
Excess-profits tax at 5%	$ 940.63
Excess-profits tax assessed	None
Deficiency of excess-profits tax	$ 940.63

[10]

EXHIBIT B

IT:R

Treasury Department
Office of
Internal Revenue Agent in Charge
Internal Revenue Service
939 South Broadway
Los Angeles, California

In re: Income & Excess-Profits Taxes
Date of report: Mar. 19, 1938

Palm Springs Holding Corp.,
El Mirador Hotel,
Palm Springs, California.

Sirs:

Recommendation:

Years	Additional Tax	Overassessment	Penalties
F.Y. Ended 5/31/36	$6,323.54	(I.T.)	
F.Y. Ended 5/31/36	940.63	(E.P.T.)	
Total	$7,264.17		

The recommendations which this office proposes to make with respect to your income tax liability as the result of a recent examination by an internal revenue agent are shown in the statement attached.

If you acquiesce in the proposed tax liability the enclosed Form 870 should be executed and forwarded to this office. Your consent to the prompt assessment and collection of any deficiency indicated

will stop the running of interest on such deficiency upon a date not later than thirty days after the filing of the Form 870 properly executed.

Should you desire to make immediate payment without awaiting formal assessment and notice and demand, you should forward your remittance to the Collector of Internal Revenue at Los Angeles, California, enclosing this letter, or a copy thereof. If payment is so made the interest period will terminate on the date of payment, and interest on the deficiency at the rate of 6 per centum per annum to the date of your payment to the Collector computed from the due date of the first installment should be included in your remittance.

If you do not acquiesce in the proposed recommendations you should file a protest in writing with this office within 30 days from the date of this letter, stating therein the grounds for your exceptions. Any protest so filed will be given careful consideration, and, if you so desire, you will be given an opportunity for a hearing before the recommendations are forwarded to Washington. See instructions attached.

Arrangements will be made by this office upon your request to answer any questions which may occur to you in your review of these recommendations.

In any event please sign the enclosed form acknowledging receipt of this letter and related papers

and return such form to this office.

Respectfully,
GEORGE D. MARTIN
Internal Revenue Agent
in Charge.

Enclosures:
Statement of adjustments.
Form 870.
Form of acknowledgment. [11]

Palm Springs Holding Corp.

F. Y. Ended 5/31/36.

PRELIMINARY STATEMENT

Additional tax is due to the fact that in computing depreciation allowable corporation used as the basis the cost to the predecessor corporation, on the ground that the assets had been acquired in a nontaxable reorganization. In audit for the fiscal year 1935 a corrected basis was arrived at by means of a Valuation Report. Such report, with the improvements and additions made during the current year, has been used as a basis for the depreciation allowable in the year under consideration. The same rates were used in the current report.

Changes were discussed with Warren B. Pinney, President of the corporation, and as he had previously accepted the findings in the report for the previous year, he concedes that the present adjustments are in order. However, he desires a copy of this report for a consultation with his accountants before executing an agreement, Form 870.

An examination of the corporation's records indicates that for the calendar year 1936 a form 940 had been filed indicating a payroll of $117,033.40 on which a tax of one percent was due under the Social Security Act computing $1,170.33 with credit for tax paid the State of California (Unemployment Insurance) of $1,053.30, leaving amount due and paid to the Bureau of Internal Revenue of $117.03.

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Schedule	1	Adjustments to Net Income
	1-A	Explanation of Items
	2	Computation of Income and Excess-Profits Taxes
Exhibit	A	Balance Sheets, June 1, 1935 and May 31, 1936
	B	Analysis of Surplus
	C	Reconciliation of Income [12]

SCHEDULE 1

ADJUSTMENTS TO NET INCOME

Net income as disclosed by return		($ 4,643.31)
As corrected		45,989.41
Net adjustment as computed below		$50,632.72
Unallowable deductions and additional income:		
(a) Depreciation on buildings overstated	$34,442.12	
(b) Depreciation on furniture & fixtures overstated	16,190.60	
Net adjustment as above		$50,632.72

SCHEDULE 1-A
EXPLANATION OF ITEMS

(a) Depreciation on buildings overstated $34,442.12

Overstatement is due to fact that corporation used as a basis for depreciation deduction cost to predecessors on the theory that same was acquired by a nontaxable reorganization. In audit of F. Y. 1935 return it was held depreciation should be based upon a cost basis. A valuation report accompanies such audit. In said report it is the basis of the buildings to June 1, 1935 that totalled

$321,314.98	Computing 20 Yrs. life figures	$16,065.75
	To arrive at current year's depreciation add	
49,640.34	current additions at 5% for 7 months— Hotel's season began 11/1/1935	1,447.85
$370,955.32		
	Allowable depreciation	$17,513.60
	Amount claimed	51,955.72
	Amount overstated	$34,442.12

Amount claimed per books was $20,862.88.

(b) Depreciation on furniture & fixtures overstated $16,190.60

Same explanation as to buildings applies here.

[13]

SCHEDULE 1-A (Continued)

In valuation report referred to basis of furniture and fixtures to June 1, 1935 totalled

$126,774.21	Computing depreciation on 12% basis figures	$15,212.90
	To arrive at current year's depreciation, add	
11,334.46	current additions at 12%	
	Rate for 6 months	680.07
$138,108.67		
	Allowable depreciation	$15,892.97
	Amount claimed	32,083.57
	Amount overstated	$16,190.60

Amount claimed per books is $13,848.49.

Unchanged items verified from books and found correct. Operating expenses contain no unallowable deductions. Hotel is open for 8 months of the year and during the closed period is subject to considerable expense in keeping same in good condition. As the hotel is located in the desert country and it is extremely hot in the closed season, it is necessary to use all precautions in such season.

SCHEDULE 2

COMPUTATION OF TAX

Income Tax

Net Income per Schedule 1	$45,989.41
Less: Interest on Liberty Bonds	None
Amount subject to Income Tax	$45,989.41
Income Tax at 13¾% on $45,989.41	$ 6,323.54
Total Tax assessable	$ 6,323.54
Tax previously assessed	None
Additional income tax to be assessed	$ 6,323.54

[14]

SCHEDULE 2 (Continued)

EXCESS-PROFITS TAX

Net Income for Excess-Profits Tax computation	$45,989.41
Declared value of capital stock for year ended June 30, 1935—$217,414.11	
Credit 12½% of $217,414.11	27,176.76
Amount subject to Excess-Profits Tax	$18,812.65
Excess-Profits tax, 5% of $18,812.65	$940.63
Excess-Profits tax assessable	$940.63
Excess-Profits tax previously assessed	None
Additional excess-profits tax to be assessed	$940.63

[15]

EXHIBIT A

BALANCE SHEETS

Assets	As of June 1, 1935 Per Books	Dr.	Cr.	Corrected	As of May 31, 1936 Per Books	Dr.	Cr.	Corrected
Cash	45,492.88			45,492.88	33,561.57			33,561.57
Accts. Receivable	3,885.40			3,885.40	6,078.31			6,078.31
Inventories, Food, S. Bev.	4,612.42			4,612.42	4,976.57			4,976.57
Prepaid Insurance	5,765.46			5,765.46	5,389.57			5,389.57
Prepaid Taxes	507.09			507.09	716.30			716.30
Bond Discount & Expense	4,485.02			4,485.02	3,877.10			3,877.10
Sundry Prepaid Expense	1,522.97			1,522.97	1,356.19			1,356.19
Buildings	300,712.47	20,602.51(a)		321,314.98	350,352.81	20,602.51(a)		370,955.32
Furniture & Fixtures	109,737.14	17,037.07(a)		126,774.21	121,071.60	17,037.07(a)		138,108.67
Miscellaneous Equipment	6,668.50			6,668.50	7,288.50			7,288.50
Delivery Equipment	1,294.57			1,294.57	1,294.57			1,294.57
Land	15,051.00	6,342.88(a)		21,393.88	31,268.73	6,342.88(a)		37,611.61
Whitewater Mutual Water Co. Stk.	3,775.00	801.16(a)		4,576.16	3,775.00	801.16(a)		4,576.16
					500.00			500.00
Discount on Preferred Stock	39,900.00			39,900.00	39,900.00			39,900.00
	543,409.92			588,193.54	611,406.82			656,190.44
Liabilities								
Reserve for Doubtful Accts.	1,500.00			1,500.00	1,500.00			1,500.00
Reserve for Depreciation on Buildings	53,042.19)	1,082.34(c)		84,773.07	73,905.07)	1,082.34(b) 1,304.80(d)		118,503.28
Reserve for Furniture & Fixtures	31,994.44)				45,842.93)			
Reserve for Del. Equipment	818.78)				1,142.42)			
Reserve for Misc. Equipment	6,915.06			6,915.06	6,564.25			6,564.25
Construction Res. Water System	2,196.34			2,196.34				
Accts. Payable	4,004.41			4,004.41	8,263.66			8,263.66
Mortgages Payable	57,000.00			57,000.00	55,000.00			55,000.00
Accrued Interest	1,662.50			1,662.50	1,604.20			1,604.20
Accrued Taxes	217.00			217.00	700.00			700.00
Due Officers	1,230.99			1,230.99	2,948.47			2,948.47
Reserve for Contingencies	4,200.00			4,200.00	12,500.00			12,500.00
Capital Stock Preferred	220,800.00			220,800.00	220,800.00			220,800.00
Capital Stock Common	15,000.00			15,000.00	15,000.00			15,000.00
Surplus	133,311.66)		(c) 45,865.96		133,311.66)			
Undivided Profits	9,516.55)			188,694.17	32,324.16)		(c & e) 47,170.76	212,806.58
	543,409.92	45,865.96	45,865.96	588,193.54	611,406.82	47,170.76	47,170.76	656,190.44

Adjustments per R. A. R. F. Y. 1935

(a) Revaluation of assets	44,783.62	
(b) Depreciation disallowed	1,082.34	
(c) Surplus		45,865.96

Adjustments per R. A. R. F. Y. 1936

(d) Depreciation disallowed	1,304.80	
(e) Surplus		1,304.80

Adjustments per R. A. R. F. Y. 1935 not made on books.

Name Palm Springs Holding Corp.

EXHIBIT B Year ended 5/31/1936

ANALYSIS OF SURPLUS AND RECONCILIATION OF AMENDED SURPLUS WITH AMENDED TAXABLE NET INCOME

Item		Per Books		Amended
Surplus beginning of period			$142,828.21	$188,694.17
Add				
Income per books and corrected taxable net income	$36,055.61		$45,989.41	
Nontaxable income for period:				
Federal C. S. T. prepaid 5/31/36			58.00	
Other credits to surplus during period:				
		36,055.61		46,047.41
		$178,883.82		$234,741.58
Deduct				
Dividends (dates):				
September 30, 1935	$ 6,624.00		$ 6,624.00	
January 31, 1936	6,624.00		6,624.00	
Income taxes				
Unallowable deductions:				
Additions to reserve			8,300.00	
Donations			370.00	
Federal C. S. T. prepaid 5/31/35			17.00	
Other charges to surplus during period:				
		13,248.00		21,935.00
Surplus end of period		$165,635.82		$212,806.58

Name Palm Springs Holding Corp.

EXHIBIT C Year ended 5/31/36

RECONCILIATION OF INCOME PER BOOKS WITH INCOME PER RETURN AND WITH TAXABLE NET INCOME

Net income per books		$36,055.61
Additions		
Additions to Reserve for Contingencies	$ 8,300.00	
Donations	370.00	
Capital Stock Tax prepaid 5/31/1935	17.00	8,687.00
		$44,742.61
Deductions		
Capital Stock Tax prepaid 5/31/1936	$ 58.00	
Additional depreciation based upon cost to predecessors	49,327.92	49,385.92
Net income per return of taxpayer		($ 4,643.31)

[Endorsed]: U.S.B.T.A. Filed Aug. 29, 1938 [18]

[Title of Board and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

1st. Admits the allegations contained in paragraph 1st. of the petition.

2nd. Admits the allegations contained in paragraph 2nd. of the petition.

3rd. Admits the allegations contained in paragraph 3rd. of the petition.

4th. Denies the allegations contained in paragraph 4th. of the petition.

5th. Admits the taxes in controversy are income and excess-profits taxes for the fiscal year ended May 31, 1936. Denies the remaining allegations contained in paragraph 5th. of the petition. [19]

6th. and 7th. Denies the allegations of error contained in paragraphs 6th. and 7th. of the petition.

8th. Denies the allegations of fact contained in paragraph 8th. of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

Wherefore, it is prayed that the petition be denied and that the respondent's determination be in all respects approved.

(Signed) J. P. WENCHEL
FTH
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,
FRANK T. HORNER,
E. A. TONJES,
Special Attorneys,
Bureau of Internal Revenue.

EAT/evl 10/7/38

[Endorsed]: U.S.B.T.A. Filed Oct. 13, 1938. [20]

[Title of Board and Cause.]

Frank Mergenthaler, Esq., for the petitioner.

E. A. Tonjes, Esq., and Frank T. Horner, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION.

This proceeding involves deficiencies in petitioner's income tax and excess-profits tax liability for the taxable year ended May 31, 1936 determined by respondent in the respective amounts of $6,323.54 and $940.63, arising by reason of respondent's disallowance in part of deductions claimed as depreciation on buildings owned by petitioner and as depreciation on furniture and fixtures. The question to be determined is what basis for depreciation these assets should have in the hands of petitioner.

[21]

FINDINGS OF FACT.

The parties have filed herein a stipulation of facts which is adopted by reference as our findings. With the exception of the exhibits attached to the stipulation, it reads as follows:

1. The petitioner is a corporation organized and existing under the laws of the State of California, with its principal office at the El Mirador Hotel of Palm Springs, California.

2. The petitioner filed its Federal income and excess-profits tax returns for the fiscal year ended May 31, 1936 with the Collector of Internal Rev-

enue for the Sixth District of California, at Los Angeles, California.

3. Palm Springs Hotel Co. was incorporated under the laws of the State of Nevada in 1927. It constructed and owned the El Mirador Hotel at Palm Springs, California, which hotel was placed in operation in January of 1928. This corporation had outstanding an issue of closed first mortgage seven per cent sinking fund gold bonds secured by a trust indenture given by said Palm Springs Hotel Co. to California Trust Co. as trustee, which was a lien upon the real property of said Palm Springs Hotel Co., which was the El Mirador Hotel property; the amount of said bonds issued and outstanding in July 1932 was $309,000. The said Palm Springs Hotel Co., on September 1, 1931, had issued and outstanding 3,213 shares of preferred stock of the par value of $100 each and 110 shares of common stock without nominal or par value.

4. The El Mirador Hotel was leased by the Palm Springs Hotel Co. to Palm Springs Hotel Operating Co., which subsequently changed its name to El Mirador Hotel Operating Co., and which latter company owned the [22] furniture and fixtures in the hotel. A chattel mortgage secured by such furniture and fixtures was given by the said lessee to Palm Springs Hotel Co. as security for performance of the terms of the lease. The said lease and chattel mortgage were assigned and pledged by Palm Springs Hotel Co. under the said trust indenture as part of the security for its said bond

issue. On September 7, 1931, the said El Mirador Hotel Operating Co. had issued and outstanding 1253 shares of its common capital stock having a par value of $100 per share. Prior to the date the outstanding stock of the El Mirador Hotel Operating Co. was sold for nonpayment of assessments as hereinafter set forth the Palm Springs Hotel Co. was the owner of 738 shares of the capital stock of El Mirador Hotel Operating Co.

5. (a) In the spring of 1931 both the Palm Springs Hotel Co. and El Mirador Hotel Operating Co. were in financial difficulties and were unable to meet their respective obligations, having sustained large operating deficits. The Palm Springs Hotel Co. levied an assessment on its capital stock amounting to $20 per share, which assessment remained unpaid, and on September 2, 1931, that company, pursuant to the laws of the State of Nevada, sold for non-payment of said assessment all of its capital stock with the exception of five shares of its common stock and five shares of its preferred stock owned by Warren B. Pinney and upon which the assessment was paid by Warren B. Pinney, the president of the corporation. The said Palm Springs Hotel Co. bought in all of the said stock at the said assessment sale with the exception of the said ten (10) [23] shares, which remained outstanding as qualifying shares, and at all times up to and including the trustee's sale hereinafter mentioned the said Warren B. Pinney was the sole stockholder of the Palm Springs Hotel Co.

(b) The El Mirador Hotel Operating Co. also levied an assessment on its capital stock amounting to $20 per share, which assessment remained unpaid, and on September 8, 1931, that company, pursuant to the laws of the State of California, sold for non-payment of said assessment all of its capital stock with the exception of ten (10) shares owned by Warren B. Pinney, the assessment on which was paid by Warren B. Pinney, who was president of said company. The said El Mirador Hotel Operating Co. bought in all of said stock at the said assessment sale with the exception of said ten (10) shares, and at all times up to and including the trustee's sale hereinafter mentioned the said Warren B. Pinney was the sole stockholder of the El Mirador Hotel Operating Co.

6. Under date of August 20, 1931, a bondholders protective committee for Palm Springs Hotel Co. first mortgage seven percent sinking fund gold bonds was formed to protect the interests of the holders of the said bonds. Hereto annexed, marked "Exhibit A" and made a part of this stipulation, is a true and correct copy of the deposit agreement under which the bonds were deposited with the said bondholders protective committee. Bonds having a par value of $167,500 were deposited with the said committee under the terms of the said deposit agreement.

7. Palm Springs Holding Corporation, the petitioner herein, was incorporated under the laws of the State of California on April 1, 1932. [24] Its

authorized capital stock consisted of 3,000 shares of 6% non-cumulative preferred stock of a par value of $100 each and 7,500 shares of common stock without par value. Hereto annexed marked "Exhibit B" and "Exhibit C" respectively are true and correct copies of the certificates of preferred and common stock of the said Palm Springs Holding Corporation. Under a permit granted by the Commissioner of Corporations of the State of California on May 4, 1932, shares of this corporation were issued, during the month of May 1932 in exchange for bonds of Palm Springs Hotel Co. and for other considerations as follows:

	Par value bonds exchanged	Stock of Pet. issued	
		Pfd. shs.	Common shs.
(a) Holders of said bonds of Palm Springs Hotel Co.	$173,000	1,038	692
(b) R. D. Lacoe	119,000	714	476
(c) R. D. Lacoe	none		6,332
	$292,000	1,752	7,500

The consideration for issuance of the several lots of shares was as follows:

(a) 6 shares of preferred stock and 4 shares of common stock were issued for each $1,000 bond in accordance with the plan of reorganization set forth in the letter of the Bondholders' Protective Committee dated March 3, 1932, a copy of which letter is hereto annexed marked "Exhibit D" and made a part hereof by reference.

(b) R. D. Lacoe was the owner of $119,000 par value of bonds which had not been deposited with

the Bondholders' Protective Committee. 714 shares of preferred stock and 476 shares of common stock of the petitioner were issued to R. D. Lacoe in accordance with the said plan of reorganization in exchange for said bonds having a par value of $119,000. [25]

(c) For his agreement to pay the costs of incorporating the petitioner up to $1,000, and for his agreement to loan moneys to the petitioner, all as set forth in the said plan of reorganization, the petitioner issued to said R. D. Lacoe all of its common capital stock not required to be issued in exchange for bonds, namely, 6332 shares.

8. On or about May 21, 1932, the trustee under said trust indenture declared the principal of all the said bonds secured thereby to be immediately due and payable. On July 15, 1932, the said trustee held a sale pursuant to the terms of said trust indenture at which the properties pledged under the trust indenture were sold to the highest bidder. Palm Springs Holding Corporation, the petitioner herein, was the successful bidder at the said sale and acquired all of the properties of Palm Springs Hotel Co., including said lease and chattel mortgage. The bid price was $61,800 which was satisfied as follows:

(a) Payment of cash, amounting to	$18,767.96
(b) By the delivery to the trustee of bonds of Palm Springs Hotel Co. having a face value of $292,000 for the balance of	43,032.04

The said properties were acquired by the petitioner subject to obligations amounting to $38,949.76, which were prior to the lien of said bonds, of which amount $13,500 represented obligations constituting a lien on the said furniture and fixtures in the said El Mirador Hotel.

9. On the 15th day of July, 1932, the California Trust Co., trustee under said trust indenture, conveyed said properties, including the said [26] lease and chattel mortgage, to the petitioner herein. Thereafter petitioner instituted foreclosure proceedings thereon in the Superior Court of the State of California, in and for the County of Riverside, action No. 23296, against Palm Springs Hotel Co. and the El Mirador Hotel Operating Co. This action proceeded to a decree of foreclosure in favor of the petitioner, the amount of the judgment for indebtedness of the El Mirador Hotel Operating Co. under the said lease and chattel mortgage being $77,918.79, and on August 2, 1932, the Sheriff of Riverside County, California, pursuant to said decree of foreclosure sold to the Palm Springs Holding Corporation, the petitioner, the furniture and fixtures in the El Mirador Hotel formerly owned by the El Mirador Hotel Operating Co. for a bid price of $20,179.25. Said furniture and fixtures constituted all of the properties of said El Mirador Hotel Operating Co.

10. W. B. Pinney was president of Palm Springs Hotel Co. and of El Mirador Hotel Operating Co., and from August 12, 1932, was president

of Palm Springs Holding Corporation, the petitioner. By agreement between said W. B. Pinney and R. D. Lacoe, reached prior to the issuance of any shares of the petitioner, W. B. Pinney received 1,000 shares of common stock of petitioner, which shares were transferred to said Pinney from said Lacoe on May 19, 1932, for services of said Pinney in the reorganization and as an inducement to continue as manager of the hotel.

11. The cost of the buildings to Palm Springs Hotel Co., including all additions up to July 15, 1932, on which date said buildings were acquired by petitioner as aforesaid, was $686,731.97. Subsequently the petitioner made additions to said buildings up to May 31, 1936, which cost the petitioner $82,652.81, which amount represented an increase in [27] the cost of said property to petitioner. The useful life of the said buildings was twenty (20) years from January 1, 1928.

12. The cost to El Mirador Hotel Operating Co. of the furniture and fixtures acquired by petitioner on August 2, 1932, as aforesaid, including all additions to said date, was $232,544.10. Subsequently petitioner acquired additional furniture and fixtures up to May 31, 1936 at a cost of $40,485.18. The useful life of said furniture and fixtures was twelve (12) years from the date of acquisition new.

13. In the issuance of the capital stock of the petitioner as set forth in paragraph 7 hereof, no

stock of the petitioner was issued to any stockholders or former stockholders of the Palm Springs Hotel Co. and the El Mirador Hotel Operating Co. for any rights which any of such stockholders might have had as stockholders of said companies.

OPINION

KERN: The first question for our decision is whether petitioner is entitled, as a basis for depreciation of its buildings, to the depreciated cost of such buildings to the Palm Springs Holding Co. It is petitioner's contention that it acquired these buildings in connection with a reorganization and immediately after the transfer an interest in such property of more than 30 per centum remained in the same persons, and that, therefore, its basis of depreciation should be the same as it would have been in the hands of the Palm Springs Hotel Co., by virtue of sections 113 (a) (7), [28] 113 (b) and 114 (a) of the Revenue Act of 1934, set out in the margin.[1] In support of this contention petitioner

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Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * * * *

(7) Transfers to Corporation where control of Property remains in same persons.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons

cites Commissioner v. Kitselman, 89 Fed. (2d) 458, cert. denied 302 U. S. 709; Newberry Lumber & Chemical Co. v. Commissioner, 94 Fed. (2d) 447; Frederick L. Leckie, 37 B.T.A. 252; and Marlborough House, Inc., 40 B.T.A. 881. Respondent does not deny that this property was acquired by petitioner as a step in a reorganization plan or that after the transfer an interest of more than 50 per centum remained in the same persons, but seeks to distinguish this proceeding from the cases above cited because in those cases the foreclosure sale pre-

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or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

* * * * * * *

(b) Adjusted Basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

Sec. 114. Basis for Depreciation and Depletion.

(a) Basis for Depreciation.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

ceded the transfer of the property to the new corporation, while in this proceed- [29] ing the bondholders exchanged their bonds for stock in the new corporation (the petitioner) and the latter foreclosed the property and applied the bonds in substantial payment therefor. We are not of the opinion that this chronological difference constitutes a valid distinction. The steps taken were obviously pursuant to and part of a plan of reorganization resulting ultimately in the acquisition by petitioner of the assets of the Palm Springs Hotel Co., and the acquisition by the bondholders of the latter of preferred stock of petitioner. Respondent also urges that it would not be proper to permit "the bondholders [of the Hotel Co.] whose investment originally cost them but $300,000 to be parties to a nontaxable reorganization, and yet, in effect, step their investment up approximately $500,000 for depreciation purposes in a corporation growing out of such a reorganization." This argument seems to be directed against the wisdom of the rule adopted in the above cited cases and not by way of distinguishing them in principle from the instant proceeding. On the authority of those cases our decision on this issue will be for petitioner. See also Alabama Asphaltic Limestone Co., 41 B.T.A. ....

The second question for our decision is whether petitioner is entitled as a basis for depreciation of its furniture and equipment to their depreciated cost to the El Mirador Hotel Operating Co. This company was not a party to the reorganization. Its

sole connection with the reorganization was by reason of the fact that it was the lessee of the buildings of the Hotel Co., and to secure its obligations under the lease had executed to the Hotel Co., a chattel mortgage covering the furniture and [30] fixtures used by it in operating the leased premises and acquired by it at a cost of $232,544.10. This lease and mortgage were assigned by the Hotel Co. to the trustee under the trust indenture securing its bonds as further security. At the time of the reorganization of the Hotel Co. the El Mirador Co. was indebed to it under its lease in the sum of $77,918.79. By virtue of the reorganization, the trustee under the trust indenture conveyed this lease and chattel mortgage to petitioner. Subsequently petitioner instituted foreclosure proceedings under this chattel mortgage and at the foreclosure sale bought the furniture and fixtures for a bid price of $20,179.25. Petitioner contends that it acquired the furniture and fixtures in connection with a reorganization and by reason of the sections of the Revenue Act already quoted is entitled to a basis of depreciation as to the furniture and fixtures of $232,544.10, the cost to the El Mirador Co.

We are unable to agree with this contention. By virtue of the wiping out of the stockholders' interests in the Palm Springs Hotel Co., the bondholders of that company were "stepped up" to the position of stockholders as to its assets according to the holding of the cases cited, and with regard to these assets the steps taken by the bondholders con-

stituted, as we have held, a transfer in connection with a reorganization. The bondholders of the Palm Springs Hotel Co. were not, however, "stepped up" to a position of stockholders in the El Mirador Hotel Operating Co. and could not be considered as owners of the physical assets of that company. They merely had a chose in action against that company. What petitioner acquired by transfer in connection with the reorganization [31] was the assets of the Palm Springs Hotel Co. including the lease obligation of the El Mirador Co. to the Hotel Co., together with the chattel mortgage securing it. Petitioner, however, is not seeking depreciation on this chose in action and its basis is not in question. Subsequent to the reorganization it sought to realize on the chose in action and the chattel mortgage securing it. In this it acted as the assignee of the original mortgage and was entitled to what rights the mortgagee Hotel Co. had. When it foreclosed the mortgage and purchased the property, its basis as to the property would be the same as it would be to any mortgagee acquiring property on foreclosure. That basis is not cost to the mortgagor. The stipulated facts do not show that either the bid price at the foreclosure sale, or the fair market value of the furniture and fixtures at the time acquired by the petitioner were in excess of the basis allowed by the respondent. See Helvering v. Midland Mutual Life Insurance Co., 300 U. S. 216; Suncrest Lumber Co., 25 B.T.A. 375; Pelham Hall Co., 33 B.T.A. 329; La Arcada Bondholders Com-

mittee, 35 B.T.A. 80. On this question we affirm the determination of the respondent.

Enter:

Decision will be entered under Rule 50.

Entered Mar. 23, 1940.

(Seal) [32]

United States Board of Tax Appeals
Washington.

Docket No. 95262

PALM SPRINGS HOLDING CORP.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion entered in the above entitled proceeding on March 23, 1940, counsel for the respondent filed, on April 16, 1940, a computation of deficiency. At the hearing under Rule 50 held on May 22, 1940, respondent's computation was not contested by petitioner. Therefore, it is

Ordered and decided: That for the taxable year ended May 31, 1936 there is a deficiency in petitioner's income tax in the amount of $3,612.78, and that there is no deficiency in excess-profits tax.

(s) JOHN W. KERN
Member.

In the United States Circuit Court of Appeals
for the Ninth Circuit

B.T.A. No. 95262

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner on Review,

v.

PALM SPRINGS HOLDING CORPORATION,

Respondent on Review.

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Now comes the Commissioner of Internal Revenue, by his attorneys, Samuel O. Clark, Jr., Assistant Attorney General, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and John M. Morawski, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

Jurisdiction

The petitioner on review is the duly appointed, qualified and acting Commissioner of Internal Revenue, hereinafter referred to as the Commissioner, holding his office by virtue of the laws of the United States.

The respondent on review, Palm Springs Holding Corporation (hereinafter referred to as the tax-

payer), is a corporation organized and existing under the laws of the State of California, with its principal office [34] at the El Mirador Hotel of Palm Springs, California. The said Palm Springs Holding Corporation filed its Federal income and excess-profits tax return for the fiscal year ended May 31, 1936, with the Collector of Internal Revenue for the Sixth District of California, at Los Angeles, California, and within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit.

The Commissioner files this petition pursuant to the provisions of Section 1141 of the Internal Revenue Code.

II.

Prior Proceedings

On June 1, 1938 the Commissioner determined deficiencies in income and excess-profits taxes for the taxable year ended May 31, 1936 in the respective amounts of $6,323.54 and $940.63, and sent to the taxpayer by registered mail a notice of said deficiencies, in accordance with the provisions of existing internal revenue laws. Thereafter, and on August 29, 1938, the taxpayer filed a petition for a redetermination of said deficiencies by the United States Board of Tax Appeals.

The case was tried before the Board of Tax Appeals on September 27, 1939, at Los Angeles, California.

On March 23, 1940, the Board entered its memorandum findings of fact and opinion, and on May

25, 1940 entered its decision that for the taxable year ended May 31, 1936 there is a deficiency in taxpayer's income tax in the amount of $3,612.78, and that there is no deficiency in excess-profits tax. [35]

III.

Nature of Controversy

The question involved is whether the taxpayer is entitled to determine depreciation of its buildings on the basis of cost to it at foreclosure sale, as contended for by the Commissioner, or on the basis of cost to the former owner, the Palm Springs Hotel Company, as contended for by the taxpayer.

The Palm Springs Hotel Company owned the El *Mirado* Hotel at Palm Springs, California. It had outstanding in July, 1932 $309,000.00 of First Mortgage bonds which were a lien on the El Mirador Hotel property. The El Mirador Hotel was leased to El Mirador Hotel Operating Company, which owned the furniture and fixtures in the hotel. A chattel mortgage, secured by such furniture and fixtures, was given by the lessee to Palm Springs Hotel Company as security for performance of the terms of the lease. The lease and chattel mortgage were pledged by Palm Springs Hotel Company as part of the security for its bond issue.

The taxpayer, Palm Springs Holding Corporation was incorporated April 1, 1932, and on May 4, 1932, shares of its capital stock were issued in exchange for $292,000 par value of bonds of Palm

Springs Hotel Company. On or about May 21, 1932, the principal of said bonds were declared due and payable, and on July 15, 1932 the properties pledged under the trust indenture were sold to the highest bidder. The taxpayer was the successful bidder and acquired all of the properties of Palm Springs Hotel Co., including the lease and chattel mortgage. The bid price was $61,800, which [36] was satisfied by payment of cash amounting to $18,767.96 and by delivery of $292,000 of bonds for the balance of $43,032.04.

In its return for the fiscal year ended May 31, 1936, the taxpayer claimed depreciation of $51,955.72 on buildings, based upon the cost to the predecessor corporation plus subsequent improvements. The cost of the buildings to Palm Springs Hotel Company up to July 15, 1932, was $686,731.97. The cost of improvements from July 15, 1932 to May 31, 1936, was $82,652.81. The Commissioner, in his notice of deficiency, allowed depreciation of $17,513.60 on buildings based on a revised cost of buildings to May 31, 1935. $321,314.98 plus additions during taxable year, $49,640.34, or a total cost of $370,955.32. The figures used by the Commissioner were based upon valuation at date of foreclosure plus subsequent additions.

The Board of Tax Appeals, however, decided this issue for the taxpayer holding that the taxpayer may use as a base for depreciation of buildings the cost to the Palm Springs Hotel Company.

IV.

ASSIGNMENTS OF ERROR

The Commissioner avers that in the record and proceeding before the Board of Tax Appeals and in the opinion and final decision rendered and entered by the Board of Tax Appeals, manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following errors and each of them, which he avers occurred in said record, proceeding, opinion and final decision so rendered and entered by the Board of Tax Appeals: [37]

1. The Board erred in holding that for the taxable year ended May 31, 1936 there is a deficiency in taxpayer's income tax in the amount of only $3,612.78, and that there is no deficiency in excess-profits tax.

2. The Board erred in failing to hold that there are deficiencies in income tax and excess-profits tax for the taxable year ended May 31, 1936 in the respective amounts of $6,323.54 and $940.63.

3. The Board erred in holding that on authority of the cases cited by it, the taxpayer acquired the hotel buildings in question in connection with a reorganization and immediately after the transfer an interest in such property of more than 50 per centum remained in the same persons and that the taxpayer's basis of depreciation should be the same as it would have been in the hands of the Palm

Springs Hotel Co., by virtue of sections 113 (a) (7), 113(b) and 114(a) of the Revenue Act of 1934.

4. The Board erred in holding that the steps taken were obviously pursuant to and part of a plan of reorganization resulting ultimately in the acquisition by taxpayer of the assets of the Palm Springs Hotel Co., and the acquisition by the bondholders of the latter of preferred stock of the taxpayer.

5. The Board erred in failing to hold that the taxpayer did not acquire its buildings in comection with a statutory reorganization and that the basis for determining depreciation on the buildings is the cost to the taxpayer upon purchase at foreclosure sale.

6. The Board erred in failing to sustain the Commissioner's determination as to depreciation allowable on buildings.

7. The Board erred in that its decision is not supported by the evidence and is contrary to law.

[38]

Wherefore, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action

be taken to the end that the errors complained of may be reviewed by said Court.

SAMUEL O. CLARK, JR.
Assistant Attorney General

(Signed) J. P. WENCHEL
RLW
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

J. M. MORAWSKI,
Special Attorney,
Bureau of Internal Revenue.

[39]

United States of America
District of Columbia—ss.

John M. Morawski, being duly sworn, says that he is a Special Attorney in the Bureau of Internal Revenue and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

JOHN M. MORAWSKI
Special Attorney,
Bureau of Internal Revenue.

Sworn and subscribed to before me this 3rd day of August, 1940.

GEORGE W. KREIS
Notary Public.

My commission expires November 15, 1942.

[Endorsed]: U.S.B.T.A. Filed Aug. 10, 1940. [40]

In the United States Circuit Court of Appeals
for the Ninth Circuit

B.T.A. Docket No. 95262

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner on Review,

v.

PALM SPRINGS HOLDING CORPORATION,

Respondent on Review.

NOTICE OF FILING PETITION FOR REVIEW

To: Palm Springs Holding Corporation,
El Mirador Hotel,
Palm Springs, California.

You are hereby notified that the Commissioner of Internal Revenue did on the 10th day of August, 1940, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 10th day of August, 1940.

(Signed) J. P. WENCHEL
RLW
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 12 day of August, 1940.

PALM SPRINGS HOLDING CORPORATION
By W. B. PINNEY, Pres.
Respondent on Review.

[Endorsed]: U.S.B.T.A. Filed Aug. 20, 1940. [41]

In the United States Circuit Court of Appeals for the Ninth Circuit

B.T.A. Docket No. 95262

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner on Review,

v.

PALM SPRINGS HOLDING CORPORATION,

Respondent on Review.

NOTICE OF FILING PETITION FOR REVIEW

To: Frank Mergenthaler, Esq.
548 South Spring Street,
Los Angeles, California.

You are hereby notified that the Commissioner of Internal Revenue did on the 10th day of Au-

gust, 1940, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 10th day of August, 1940.

(Signed) J. P. WENCHEL
RLW
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 12 day of August, 1940.

(Sgd) FRANK MERGENTHALER
Counsel for Respondent on Review.

[Endorsed]: U.S.B.T.A. Filed Aug. 20, 1940. [42]

In the United States Circuit Court of Appeals
for the Ninth Circuit

B.T.A. No. 95262

PALM SPRINGS HOLDING CORPORATION,
Petitioner on Review,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent on Review.

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Comes now the Palm Springs Holding Corporation, the Petitioner on Review, above named, (hereinafter referred to as the taxpayer) by its attorney, Frank Mergenthaler, and respectfully shows:

I.

Jurisdiction

That the Petitioner on Review is a corporation organized and existing under the laws of the State of California, with its principal office at the El Mirador Hotel, Palm Springs, California. Said Palm Springs Holding Corporation filed its Federal income and excess-profits tax return for the fiscal year ended May 31, 1936, with the Collector of Internal Revenue for the Sixth District of California, at Los Angeles, California [43] and within

the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit.

The Respondent on Review is the duly appointed, qualified and acting Commissioner of Internal Revenue, and is hereinafter referred to as the Commissioner, who holds his office by virtue of the laws of the United States.

The Petitioner on Review files this Petition pursuant to the provisions of §1141 of the United States Internal Revenue Code, for a review of a portion of the decision of the United States Board of Tax Appeals.

II.

Prior Proceedings

On or about the 1st day of June, 1938, the Commissioner of Internal Revenue mailed to the taxpayer a ninety day letter advising it of a determination of deficiency in its income tax liability for the taxable year ended May 31, 1936, in the sum of $6,323.54, and a determination of deficiency in its excess-profits tax liability for the same year in the sum of $940.63. On the 29th day of August, 1938, the taxpayer filed a petition for a redetermination of said deficiencies by the United States Board of Tax Appeals. On the 13th day of October, 1938, the Commissioner filed his Answer to said Petition, denying the material allegations of said petition.

The case being at issue it was tried before the United States Board of Tax Appeals on September 27, 1939, at Los Angeles, California. On the 23rd

day of March, 1940, the [44] United States Board of Tax Appeals entered its Memorandum Findings of Fact and Opinion, and on May 25, 1940, the said Board entered its Decision that for the taxable year ended May 31, 1936, there is a deficiency in the taxpayer's income tax in the amount of $3,612.78, and that there is no deficiency in excess-profits tax.

III.

Nature of Controversy

The question involved is whether the taxpayer is entitled to determine depreciation of its furniture and fixtures on the basis of their fair market value at the date of foreclosure of the chattel mortgage, as contended for by the Commissioner, or on the basis of cost to the former owner.

A corporation known as the Palm Springs Hotel Company owned the El Mirador Hotel at Palm Springs, California. In July of 1932, there were $309,000.00 of First Mortgage bonds of the Palm Springs Hotel Company outstanding which were a lien upon the El Mirador Hotel property. The El Mirador Hotel was leased to the El Mirador Hotel Operating Company, which owned the furniture and fixtures in the hotel. A chattel mortgage, secured by such furniture and fixtures, was given by the lessee to Palm Springs Hotel Company as security for the performance of the terms of the lease. The lease and chattel mortgage were pledged by Palm Springs Hotel Company as part of the security for its bond issue. [45]

The taxpayer, the Palm Springs Holding Corporation, was incorporated under the laws of the State of California, on April 1, 1932, and during the month of May, 1932, issued all its capital stock in exchange for $292,000.00 par value of said bonds of the Palm Springs Hotel Company. The taxpayer was formed for the purpose of acquiring the said bonds and ultimately the properties of the Palm Springs Hotel Company and of the El Mirador Hotel Operating Company.

On July 15, 1932, the Trustee sold all of the property securing the bond issue, including the above mentioned lease and chattel mortgage, to the taxpayer, who was the highest bidder; the bid price was $61,800.00, which was paid as follows: Cash $18,767.96; $292,000.00 par value of bonds for the balance of the bid price, to wit: $43,032.04.

Thereafter and on August 2, 1932, the taxpayer foreclosed the chattel mortgage on the furniture and fixtures. Said furniture and fixtures were sold to the taxpayer by the Sheriff pursuant to the foreclosure for a bid price of $20,179.25. The amount of the judgment for indebtedness of the El Mirador Hotel Operating Company under the lease and chattel mortgage was $77,918.79. The said furniture and fixtures constituted all of the properties of the El Mirador Hotel Operating Company. The Commissioner based his determination of the depreciation upon the furniture and fixtures upon what he claimed to be the fair market value thereof as of the [46] date of foreclosure of the chattel mortgage.

In its return for the fiscal year ended May 31, 1936, the taxpayer claimed depreciation on furniture and fixtures in the sum of $32,083.57, based upon the cost to the El Mirador Hotel Operating Company plus subsequent improvements. The cost to the El Mirador Hotel Operating Company of the furniture and fixtures acquired by the taxpayer on August 2, 1932, as aforesaid, including all additions up to date, was $232,544.10. Subsequently the taxpayer acquired additional furniture and fixtures up to May 31, 1936, at a cost of $40,485.18. The useful life of said furniture and fixtures was twelve years from the date of acquisition new.

The Commissioner in his Notice of Deficiency allowed depreciation of $15,892.97 on furniture and fixtures based on a revised cost of furniture and fixtures to May 31, 1935, $126,774.21, plus additions during taxable year, $11,334.46, or a total cost of $138,108.67. The figures used by the Commissioner were based upon valuation at date of foreclosure plus subsequent additions.

The Board of Tax Appeals decided the issue of depreciation on furniture and fixtures for the Commissioner holding that the taxpayer must use as a base for depreciation of furniture and fixtures the fair market value as of the date of the foreclosure, plus cost of additions. [47]

IV.

ASSIGNMENTS OF ERROR

The taxpayer avers that in the record and proceedings before the Board of Tax Appeals, and in the opinion and final decision rendered and entered by the said Board of Tax Appeals, manifest error occurred and intervened to the prejudice of the taxpayer, who now assigns the following errors, and each of them, which it avers occurred in said record, proceeding, opinion and final decision so rendered by the Board of Tax Appeals:

1. The Board erred in holding that for the taxable year ended May 31, 1936, there is a deficiency in the taxpayer's income tax in the amount of $3,612.78.

2. The Board erred in holding that the bondholders of the Palm Springs Holding Corporation were not stepped up to a position as stockholders in the El Mirador Hotel Operating Company and could not be considered as owners of the physical assets of that company.

3. The Board erred in holding that when the taxpayer foreclosed the chattel mortgage and purchased the furniture and fixtures its basis for that property was the same as it would be to any mortgagee acquiring property on foreclosure.

4. The Board erred in failing to find that the acquisition of the furniture and fixtures was pursuant to a plan of re-organization, and in failing to find that the El Mirador Hotel Operating Company was a party to the re-organization. [48]

5. The Board erred in failing to sustain the taxpayer's contention that it was entitled to depreciation on the basis of costs to the El Mirador Hotel Operating Co.

6. The Board erred in that the following portion of the decision is not supported by the evidence and is contrary to the law:

"That for the taxable year ended May 31, 1936, there is a deficiency in taxpayer's income tax in the amount of only $3,612.78."

Wherefore, the taxpayer petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of be reviewed by said Court.

PALM SPRINGS HOLDING CORPORATION
By W. B. PINNEY
President

FRANK MERGENTHALER
Attorney for Petitioner:
548 South Spring Street—Room 1104
Los Angeles, California [49]

United States of America,
Southern District of California—ss.

Warren B. Pinney, being duly sworn, says that he is the President of Palm Springs Holding Corporation, the petitioner in the foregoing petition for review; that he has read the said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

WARREN B. PINNEY

Subscribed and sworn to before me this 15 day of August, 1940.

JESS CHENOWETH
Notary Public in and for the County of Los Angeles, State of California

My Commission expires June 3, 1943

[Endorsed]: U. S. B. T. A. Filed Aug. 22, 1940.

[50]

In the United States Circuit Court of Appeals
for the Ninth Circuit

B. T. A. Docket No. 95262

PALM SPRINGS HOLDING CORPORATION,
Petitioner on Review,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent on Review.

NOTICE OF FILING PETITION FOR REVIEW

To: Samuel O. Clark, Jr., Esq.,
Assistant Attorney General
J. P. Wenchel, Esq.,
Chief Counsel,
Bureau of Internal Revenue
John W. Morowski, Esq.
Special Attorney,
Bureau of Internal Revenue
Attorneys for Respondent above named

You are hereby notified that Palm Springs Holding Corporation, the above named Petitioner, did on the 22d day of August, 1940, file with the Clerk of the United States Board of Tax Appeals a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of a portion of the decision of the Board heretofore rendered in the above entitled cause. A copy of the

petition for review and assignments of error as filed is hereto attached and served upon you.

Dated this 22d day of August, 1940.

FRANK MERGENTHALER
Attorney for Petitioner on Review
548 South Spring Street
Los Angeles, California

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 22d day of August, 1940.

J. P. WENCHEL
EHJ
Counsel for Respondent on Review

[Endorsed] U. S. B. T. A. Filed Aug. 22, 1940.

[51]

In the United States Circuit Court of Appeals
for the Ninth Circuit

B. T. A. No. 95262

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner on Review,

v.

PALM SPRINGS HOLDING CORPORATION,

Respondent on Review.

STATEMENT OF POINTS

Comes Now the petitioner on review herein and

makes this concise Statement of Points on which he intends to rely on the review herein, to-wit:

The United States Board of Tax Appeals erred:

1. In holding that for the taxable year ended May 31, 1936 there is a deficiency in taxpayer's income tax in the amount of only $3,612.78, and that there is no deficiency in excess-profits tax.

2. In failing to hold that there are deficiencies in come tax and excess-profits tax for the taxable year ended May 31, 1936 in the respective amounts of $6,323.54 and $940.63.

3. In holding that on authority of the cases cited by it, the taxpayer acquired the hotel buildings in question in connection with a reorganization and immediately after the transfer an interest in such property of more than 50 per centum remained in the same persons and that the taxpayer's basis of depreciation should be the same as it would have been in the hands of the Palm Springs Hotel Co., by virtue of sections 113(a)(7), 113(b) and 114(a) of the Revenue Act of 1934. [52]

4. In holding that the steps taken were obviously pursuant to and part of a plan of reorganization resulting ultimately in the acquisition by taxpayer of the assets of the Palm Springs Hotel Co., and the acquisition by the bondholders of the latter of preferred stock of the taxpayer.

5. In failing to hold that the taxpayer did not acquire its buildings in connection with a statutory reorganization and that the basis for determining

depreciation on the buildings is the cost to the taxpayer upon purchase at foreclosure sale.

6. In failing to sustain the Commissioner's determination as to depreciation allowable on buildings.

7. In that its decision is not supported by the evidence and is contrary to law.

(Signed) J. P. WENCHEL RLW
Chief Counsel,
Bureau of Internal Revenue.

Service of a copy of the above statement of points is hereby acknowledged this 19 day of August, 1940.

(Sgd) FRANK MERGENTHALER
Attorney for Respondent on Review.

JMM-pp 8-16-40

[Endorsed]: U. S. B. T. A. Filed Aug. 22, 1940.

[53]

In the United States Circuit Court of Appeals
for the Ninth Circuit

B. T. A. Docket No. 95262

PALM SPRINGS HOLDING CORPORATION,
Petitioner on Review,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue

Respondent on Review.

STATEMENT OF POINTS

Comes now Palm Springs Holding Corporation, the petitioner on review herein, and makes this concise statement of points upon which it intends to rely on the review herein, to wit:

The United States Board of Tax Appeals erred:

1. In holding that for the taxable year ended May 31, 1936, there is a deficiency in the taxpayer's income tax in the amount of $3,612.78.

2. In failing to hold that the taxpayer acquired furniture and fixtures in question in connection with the re-organization.

3. In failing to hold that the taxpayer's basis for depreciation on said furniture and fixtures should be the same as it would have been in the hands of the Palm Springs Hotel Operating Company by virtue of Sections [54] 113(a)(7), 113(b) and 114(a) of the Revenue Act of 1934.

4. In failing to hold that the steps taken were pursuant to and part of the plan of re-organization

resulting ultimately in the acquisition by the taxpayer of the assets of the Palm Springs Hotel Operating Company, and the acquisition by the bondholders of the latter of preferred stock of the taxpayer.

5. In that its decision insofar as it relates to the furniture and fixtures acquired by the taxpayer is not supported by the evidence and is contrary to law.

FRANK MERGENTHALER
Attorney for Palm Springs Holding Corporation, Petitioner on Review

Service of a copy of the above statement of points is hereby acknowledged this 5th day of Sept., 1940.

(Signed) J. P. WENCHEL CAR
Attorney for Respondent on Review

[Endorsed]: U. S. B. T. A. Filed Sept. 5, 1940.

[55]

In the United States Circuit Court of Appeals for the Ninth Circuit

B. T. A. No. 95262

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner on Review,

v.

PALM SPRINGS HOLDING CORPORATION,

Respondent on Review.

DESIGNATION OF PORTIONS OF THE RECORD TO BE PRINTED

Comes now the petitioner on review herein, and complying with the rules of this Court, pertaining to the designation of the portion of the record to be printed, states that he relies upon the entire record certified by the Clerk of the Board of Tax Appeals to this Court, and directs that said record so certified be printed as the record on review.

Respectfully submitted,

(Signed) J. P. WENCHEL
RLW
Chief Counsel, Bureau of Internal Revenue.

Consented to:

(Sgd) FRANK MERGENTHALER
Attorney for Respondent.

JMM-pp 8-16-40

[Endorsed]: U. S. B. T. A. Filed Aug. 22, 1940.

[56]

In the United States Circuit Court of Appeals
for the Ninth Circuit

B. T. A. Docket No. 95262

PALM SPRINGS HOLDING CORPORATION,
Petitioner on Review,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent on Review.

DESIGNATION OF PORTIONS OF THE RECORD TO BE PRINTED

Comes now the Palm Springs Holding Corporation, the petitioner on review herein, and complying with the rules of this Court, pertaining to the designation of the portion of the record to be printed, states that it relies upon the entire record certified by the Clerk of the Board of Tax Appeals to this Court, and directs that said record so certified be printed as the record on review.

The respondent on review has filed petition for review and designation of portions of the record to be printed, and it is the intention of the Palm Springs Holding Corporation to use said record in order to avoid duplication of same.

Respectfully submitted,
FRANK MERGENTHALER
Attorney for Palm Springs Holding Corporation, Petitioner on Review

Consented to:

(Signed) J. P. WENCHEL CAR
Attorney for Respondent on Review

[Endorsed]: U. S. B. T. A. Filed Sept. 5, 1940

[57

In the United States Circuit Court of Appeals
for the Ninth Circuit

B. T. A. No. 95262

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner on Review,

v.

PALM SPRINGS HOLDING CORPORATION

Respondent on Review.

DESIGNATION OF PORTIONS OF RECORD, PROCEEDINGS, AND EVIDENCE TO BE CONTAINED IN RECORD ON REVIEW

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause, in connection with the peti-

tion for review by the said Circuit Court of Appeals for the Ninth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries.
2. Pleadings:
   (a) Petition.
   (b) Answer to petition.
3. Board's memorandum findings of fact and opinion entered March 23, 1940, including Exhibits A, B, C and D attached to the stipulation of facts which is adopted by reference as the Board's findings, the stipulated facts with the exception of the exhibits being set out in the Board's findings of fact. (Photostatic copies of said Exhibits A, B, C and D will be furnished by petitioner on review to be transmitted with the certified transcript of record to the Clerk of the Court of Appeals; the photostats to be bound in the printed record at the appropriate place.) [58]
4. Board's decision entered May 25, 1940.
5. Petition for review.
6. Notices of filing petition for review.
7. Statement of points.
8. Designation of portions of the record to be printed.
9. This designation.

(Signed) J. P. WENCHEL
RLW
Chief Counsel, Bureau of Internal Revenue.

Service of a copy of the within designation of portions of record, proceedings, and evidence to be contained in record on review is hereby admitted and the portions so designated agreed to this 19 day of August, 1940.

(Sgn) FRANK MERGENTHALER
Attorney for Respondent on Review.

JMM-pp 8-16-40

[Endorsed]: U. S. B. T. A. Filed Aug. 22, 1940.

[59]

In the United States Circuit Court of Appeals for the Ninth Circuit

B. T. A. Docket No. 95262

PALM SPRINGS HOLDING CORPORATION,
Petitioner on Review,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent on Review.

DESIGNATION OF PORTIONS OF RECORD, PROCEEDINGS AND EVIDENCE TO BE CONTAINED IN RECORD ON REVIEW

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of

Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above entitled cause, in connection with the petition for review by the said Circuit Court of Appeals for the Ninth Circuit, heretofore filed by Palm Springs Holding Corporation:

1. Docket entries.
2. Pleadings:
   (a) Petition.
   (b) Answer to petition.
3. Board's memorandum findings of fact and opinion entered March 23, 1940, including Exhibits A, B, C and D attached to the stipulation of facts which is adopted by reference as the [60] Board's findings, the stipulated facts with the exception of the exhibits being set out in the Board's findings of fact. (Photostatic copies of said Exhibits A, B, C and D will be furnished by petitioner on review to be transmitted with the certified transcript of record to the Clerk of the Court of Appeals; the photostats to be bound in the printed record at the appropriate place.)
4. Board's decision entered May 25, 1940.
5. Petition for review.
6. Notices of filing petition for review.
7. Statement of points.
8. Designation of portions of the record to be printed.
9. This designation.

The Commissioner of Internal Revenue has heretofore also filed a petition for review in the above

matter and has designated portions of the record, proceedings and evidence to be contained in the record on review. In order to avoid duplication it is the intention of Palm Springs Holding Corporation to use the same record.

FRANK MERGENTHALER
Attorney for Palm Springs Holding Corporation, Petitioner on Review

Service of a copy of the within designation of portions of record, proceedings, and evidence to be contained in record on review is hereby admitted and the portions so designated agreed to this 5th day of Sept., 1940.

(Signed) J. P. WENCHEL CAR
Attorney for Respondent on Review

[Endorsed]: U. S. B. T. A. Filed Sept. 5, 1940.

[61]

In the United States Circuit Court of Appeals
for the Ninth Circuit

B. T. A. Docket No. 95262

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner on Review,

v.

PALM SPRINGS HOLDING CORPORATION,

Respondent on Review.

PALM SPRINGS HOLDING CORPORATION,

Petitioner on Review,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent on Review.

ORDER

Upon consideration of the joint motion filed herein by counsel for the parties in the above-entitled proceedings, it is hereby ordered:

1. That the above-entitled proceedings be and they are hereby ordered consolidated for briefing, hearing, argument, and decision upon a single consolidated transcript of record, consisting of such portions of the record made before the United States Board of Tax Appeals as the parties herein may indicate by their designations, omitting any repetition of documents.

2. That the cost of the printing of the consolidated record on review be borne one-half by each of the petitioners on review.

And it is further ordered that the Clerk of this Court transmit to the Clerk of the United States Board of Tax Appeals a certified copy of this order to be by him incorporated in the record on review as certified and transmitted by him to this Court.

By the Court

(s) CURTIS D. WILBUR
Judge, U. S. Circuit Court of Appeals.

Dated: San Francisco, Calif.

[Endorsed]: Filed: September 13, 1940. Paul P. O'Brien, Clerk.

A true copy:

Attest: September 14, 1940.
PAUL P. O'BRIEN,
Clerk
By FRANK H. SCHMID
Deputy

[Endorsed]: U. S. B. T. A. Filed Sept. 16, 1940.

[62]

[Title of Board and Cause.]

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 62, inclusive, contain and are a true copy of the

transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 27th day of September, 1940.

B. D. GAMBLE
Clerk, United States Board of
Tax Appeals.

EXHIBIT A

Bondholders' Protective Agreement

PALM SPRINGS HOTEL COMPANY

First Mortgage Seven Percent Sinking Fund Gold Bonds

THIS AGREEMENT, made and entered into as of the 20th day of August, 1931, by and between A. R. LEROY and E. A. GRUMM, residing in the County of Los Angeles, California, and RALPH D. LACOE, JR. residing in the County of San Diego, California, as Parties of the First Part, hereby appointed a Bondholders' Protective Committee for the purposes described in this agreement, and herein, together with their successors, designated for convenience as the "Committee" and such holders of the First Mortgage Seven Per Cent Sinking Fund Gold Bonds of Palm Springs Hotel Company, a Nevada corporation, as shall become parties to this agreement in the manner herein provided (which Parties and their respective transferees are herein referred to as the Depositing Bondholders) Parties of the Second Part.

WITNESSETH:

THAT, WHEREAS, said Palm Springs Hotel Company (hereinafter called the "Company") has heretofore executed and delivered to California Trust Company (hereinafter called the "Trustee") a certain Trust Indenture dated as of June 15, 1927 and a supplemental Trust Indenture dated as of June 15th, 1928 (said Trust Indentures being hereinafter referred to as "Indenture"), securing the payment of $325,000.00 principal amount of its First Mortgage Seven Per Cent Sinking Fund Gold Bonds (of which there are now unredeemed and outstanding $309,000.00 in principal amount thereof hereinafter called "Bonds") and

WHEREAS, the Company is now in default in the performance of certain of the covenants contained in said Indenture and said Bonds and it is the desire of the Committee and of the depositing bondholders to provide a means whereby the Company may be able to perform its obligations under said Indenture and Bonds as they now exist or as they may be modified and extended to the extent as hereinafter provided and/or if necessary for refinancing and/or reorganization of the Company and/or for the foreclosure of said Indenture and/or the sale of property covered thereby as provided in said Indenture.

NOW, THEREFORE, in consideration of the deposit of bonds as herein provided and in further consideration of the services to be performed by the Committee and of the advantages which will accrue to the Depositing Bondholders from union of interest and concerted action,

IT IS MUTUALLY AGREED AS FOLLOWS: to-wit:

I.

Any holder of said bonds issued under and secured by said Indenture, may become a party to this agreement by depositing the said bonds held by him in negotiable form together with the interest coupons attached thereto and maturing June 15, 1931 and subsequent thereto, with CALIFORNIA TRUST COMPANY, a corporation, (hereinafter referred to as the Depositary) at its head office in the City of Los Angeles, California, within sixty days from the date of this agreement or such further time as the Committee may from time to time determine. Upon the deposit of any such bonds with the Depositary as aforesaid, a certificate of deposit shall be issued by the depositary, in substantially the following form:

No. Principal Amount $

CERTIFICATE OF DEPOSIT
of
PALM SPRINGS HOTEL COMPANY
First Mortgage Seven Per Cent Sinking Fund Gold Bonds

THIS CERTIFIES that has deposited with CALIFORNIA TRUST COMPANY (hereinafter called the Depositary) at its head office in the City of Los Angeles, California, ($)

Dollars

aggregate principal face amount of the First Mortgage Seven Per Cent Sinking Fund Gold Bonds of the Palm Springs Hotel Company, a Nevada corporation, issued under that certain mortgage or deed of trust dated as of June 15th, 1927 and/or that certain supplemental mortgage or deed of trust dated as of June 15th, 1928 executed by said Palm Springs Hotel Company, a Nevada corporation, to California Trust Company, as Trustee.

There is also deposited with each bond the coupon appertaining thereto due June 15, 1931, and all such coupons due thereafter. Such securities are deposited and received and this certificate is issued subject to and for the purposes and uses specified in an agreement dated as of the 20th day of August, 1931, and now on file in the said head office of the Depositary between the holders of said bonds depositing same thereunder and A. R. LEROY, E. A. GRUMM and RALPH D. LACOE, JR. as a protective committee subject to the sole control, direction and disposition of said Committee and its successors. The Depositor herein named and each successive holder of this certificate by acceptance hereof, approves and becomes a party to and bound by said agreement to which, as to the whole and each and all of the terms and conditions thereof, reference is hereby expressly made.

This certificate is transferable only on the books of the Depositary under said agreement, upon surrender hereof to it at its head office, duly assigned, and the Depositary shall not be bound to take notice of or be affected by any trust respecting the title or ownership of this certificate or the bonds and/or coupons represented thereby.

Dated at Los Angeles, California, , 1931.

CALIFORNIA TRUST COMPANY, Depositary

Any holder of said bonds issued under and secured by said Indenture, may become a party to this agreement by depositing the said bonds held by him in negotiable form together with the interest coupons attached thereto and maturing June 15, 1931 and subsequent thereto, with CALIFORNIA TRUST COMPANY, a corporation, (hereinafter referred to as the Depositary) at its head office in the City of Los Angeles, California, within sixty days from the date of this agreement or such further time as the Committee may from time to time determine. Upon the deposit of any such bonds with the Depositary as aforesaid, a certificate of deposit shall be issued by the Depositary, in substantially the following form:

No. Principal Amount $

CERTIFICATE OF DEPOSIT
of
PALM SPRINGS HOTEL COMPANY
First Mortgage Seven Per Cent Sinking Fund Gold Bonds

THIS CERTIFIES that has deposited with CALIFORNIA TRUST COMPANY (hereinafter called the Depositary) at its head office in the City of Los Angeles, California, ($)

Dollars

aggregate principal face amount of the First Mortgage Seven Per Cent Sinking Fund Gold Bonds of the Palm Springs Hotel Company, a Nevada corporation, issued under that certain mortgage or deed of trust dated as of June 15th, 1927 and or that certain supplemental mortgage or deed of trust dated as of June 15th, 1928 executed by said Palm Springs Hotel Company, a Nevada corporation, to California Trust Company, as Trustee.

There is also deposited with each bond the coupon appertaining thereto, due June 15, 1931, and all such coupons due thereafter. Said securities are deposited and received and this certificate is issued subject to and for the purposes and uses specified in an agreement dated as of the 20th day of August, 1931, and now on file in the said head office of the Depositary between the holders of said bonds depositing same thereunder and A. R. LEROY, E. A. GRUMM and RALPH D. LACOE, JR. as a protective committee subject to the sole control, direction and disposition of said Committee and its successors. The Depositor herein named and each successive holder of this certificate by acceptance hereof, approves and becomes a party to and bound by said agreement to which, as to the whole and each and all of the terms and conditions thereof, reference is hereby expressly made.

This certificate is transferable only on the books of the Depositary under said agreement, upon surrender hereof to it at its head office, duly assigned, and the Depositary shall not be bound to take notice of or be affected by any trust respecting the title or ownership of this certificate or the bonds and/or coupons represented thereby.

Dated at Los Angeles, California, , 1931.

CALIFORNIA TRUST COMPANY, Depositary

By

Authorized Officer.

(Reverse Side of Certificate)

FOR VALUE RECEIVED

hereby sell, transfer and assign to

whose address is

subject to the terms and conditions of the herein mentioned agreement, all right, title and interest in and to the herein described bonds, together with all of the benefits and advantages to which may be entitled thereunder and growing out of said agreement.

, 1931.

After any such deposit no separate action shall be taken by a Depositing Bondholder with respect to the bonds and or coupons so deposited. It is the intent and purpose of this agreement, and therefore hereby agreed, by and between the Depositing Bondholders and the Committee, that all bonds and/or coupons so deposited hereunder shall (except as herein otherwise provided) be held by the Depositary until, in the judgment of the Committee, there shall no longer be any necessity for any action by the Committee that may be

authorized hereunder, in which event the Depositing Bondholders shall be entitled to the delivery of the bonds and/or coupons severally deposited by them, as provided in Article XI hereof. The deposit of the bonds and, coupons and/or the acceptance of a certificate of deposit therefor shall have the same force and effect as though the depositing bondholder had been named in and had subscribed to this agreement. The certificates of deposit may be transferred by delivery thereof, properly endorsed, but no such transfer shall be effectual unless registered in the office of the Depositary. Upon the transfer of any certificate of deposit, the transferee (after entry of such transfer on the records of the Depositary) shall for all purposes be substituted for the prior holder of such certificate of deposit and the registered holders for the time being of the respective certificates of deposit may be treated as the absolute owners thereof and entitled to all rights of the original Depositing Bondholders. Each Depositing Bondholder shall file with the Depositary his address at which notices may be directed to him.

II.

To the end that the Committee may be able to protect and promote the interests of the Depositing Bondholders, the Committee is hereby vested under the terms of this agreement as trustees of an express trust with legal title to and ownership of all the bonds and coupons deposited hereunder, and the Depositing Bondholders hereby, for the consideration aforesaid, and each also in consideration of the assignment and transfer to the Committee of the bonds and coupons of the Depositing Bondholders respectively by them hereunder, does hereby transfer and assign all of his right, title and interest in and to said bonds and coupons deposited by him hereunder to the Committee, and no limitation is imposed on the powers of the Committee as the legal owner except the duty of doing whatever is calculated in its opinion to promote the interests of the Depositing Bondholders without preference or priority of any of them over any other of them, and the Committee hereby assumes such duty.

The Depositing Bondholders hereby further irrevocably constitute and appoint the Committee their attorneys in fact and the attorneys in fact of each of them, and hereby authorize and empower the Committee in the name of and on behalf of the Depositing Bondholders, to institute, intervene in and defend such legal proceedings, and to file such protests, consents or other instruments necessary, convenient or requisite in connection with any remedies provided for in the deed of trust in the event of a default by the Company as may in the judgment of the Committee protect the interests of the Depositing Bondholders, and to take any other action, step, or proceeding to enforce any director's, officer's and/or stockholder's liability under the provisions of the statutes and constitution of the State of California, and to do, take and perform any other act, proceeding or thing which the Depositing Bondholders themselves, or any of them, might or could do if this agreement had not been made.

The Depositing Bondholders will at the request of the Committee execute such further instruments as shall be convenient and proper to make most effective the foregoing assignment and appointment.

III.

Without hereby limiting the general powers vested in it, the Committee is specifically authorized, in its discretion to purchase any or all of the property which constitutes the security for said bonds, for the account of the Depositing Bondholders on any terms which the Committee accepts; to apply the deposited bonds and coupons, or any of them, in satisfaction of any bid or purchase price in the event of foreclosure sale or Trustee's sale of the secured property; to sell, pledge, mortgage, hypothecate, transfer, and/or assign or otherwise dispose of all or any of the said bonds and coupons and real and personal property purchased or acquired by or on behalf of the Committee, for the purpose of borrowing or raising funds necessary in the judgment of the Committee to be borrowed or raised to carry out the trusts hereby assumed or for any other purpose to serve the interests of the Depositing Bondholders; to expend the moneys so realized for such purposes as in its uncontrolled discretion it deems to be for the best interests of the Depositing Bondholders, including the loaning or advancing of money to the company either with or without security and the repayment to CALIFORNIA TRUST COMPANY, Trustee, of any indebtedness incurred by it (whether before or after the execution hereof) in carrying out any of the trusts of said indenture or this agreement or any directions of the Committee, with legal interest on each such advance or expenditure from the date thereof until such reimbursement; as well as the compensation of said Trustee; to sell for cash or on terms or to exchange any property purchased at foreclosure sale or Trustee's sale or otherwise in behalf of and in trust for the Depositing Bondholders, and to accept cash, mortgage interests in land, improved or unimproved, and shares of stocks, bonds, securities, notes and other personal property in payment of all or any part of the purchase price; to sell or otherwise dispose of the deposited bonds and coupons; to take possession or control of and operate all or any of the mortgaged property to be transferred and conveyed to any bank and/or trust company authorized to conduct a trust business in the State of California in trust for the Depositing Bondholders in proportion to their respective interests, which trust shall be for such purposes, in such form, for such period of time and upon such terms and conditions as the Committee in its sole discretion shall deem advisable, with power to borrow such sum or sums of money secured by the terms of any such trust from time to time as may be necessary in the judgment of the Committee to be raised to fully carry out the purposes and terms of this agreement, and each Depositing Bondholder by becoming a party hereto in the manner herein set forth does hereby confirm and approve any such declaration of trust and each and all of the terms, covenants, provisions and conditions that may be therein contained and set forth.

IV.

No member of the Committee and any firm, association or corporation of which he may be a member, officer, director or stockholder, the Depositary above named and any officer, director or stockholder of the Company may become pecuniarily interested in any property, matters which are or may become the subject of this agreement, and may contract with the Committee with reference to any of such property, matters, the Depositing Bondholders hereby consenting thereto.

V.

The Committee may limit or extend the time within which bonds may be deposited under this agreement, and no bondholder failing to deposit his bonds within the time limited by the Committee, shall have any right to become a party to this agreement without the express written consent of the Committee. Neither the Committee nor any of its members shall be personally liable for any act or omission in accordance with the advice of counsel, attorney or agent selected in good faith, nor for any error of judgment, nor mistake of fact or law, nor upon any agreement or other instrument signed or entered into by the Committee or authorized by it. No member of the Committee shall be liable for the acts, default or defaults, of any other member, nor for anything but his own individual wilful misconduct. The Committee

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Without hereby limiting the general powers vested in it, the Committee is specifically authorized, in its discretion to purchase any or all of the property which constitutes the security for said bonds, for the account of the Depositing Bondholders on any terms which the Committee accepts; to apply the deposited bonds and coupons, or any of them, in satisfaction of any bid or purchase price in the event of foreclosure sale or Trustee's sale of the secured property; to sell, pledge, mortgage, hypothecate, transfer, and/or assign or otherwise dispose of all or any of the said bonds and coupons and real and personal property purchased or acquired by or on behalf of the Committee, for the purpose of borrowing or raising funds necessary in the judgment of the Committee to be borrowed or raised to carry out the trusts hereby assumed or for any other purpose to serve the interests of the Depositing Bondholders; to expend the moneys so realized for such purposes as in its uncontrolled discretion it deems to be for the best interests of the Depositing Bondholders, including the loaning or advancing of money to the company either with or without security and the repayment to CALIFORNIA TRUST COMPANY, Trustee, of any indebtedness incurred by it (whether before or after the execution hereof) in carrying out any of the trusts of said indenture or this agreement or any directions of the Committee, with legal interest on each such advance or expenditure from the date thereof until such reimbursement, as well as the compensation of said Trustee; to sell for cash or on terms or to exchange any property purchased at foreclosure sale or Trustee's sale or otherwise in behalf of and in trust for the Depositing Bondholders, and to accept cash, land or interests in land, improved or unimproved, and shares of stocks, bonds, securities, notes and other personal property in payment of all or any part of the purchase price; to sell or otherwise dispose of the deposited bonds and coupons; to take possession or control of and operate all or any of the mortgaged property to be transferred and conveyed to any bank and/or trust company authorized to conduct a trust business in the State of California in trust for the Depositing Bondholders in proportion to their respective interests, which trust shall be for such purposes, in such form, for such period of time and upon such terms and conditions as the Committee in their sole discretion shall deem advisable, with power to borrow such sum or sums of money secured by the terms of any such trust from time to time as may be necessary in the judgment of the Committee to be raised to fully carry out the purposes and terms of this agreement, and each Depositing Bondholder by becoming a party hereto in the manner herein set forth does hereby confirm and approve any such declaration of trust and each and all of the terms, covenants, provisions and conditions that may be therein contained and set forth.

IV.

Any member of the Committee and any firm, association or corporation of which he may be a member, officer, director or stockholder, and the Depositary above named and any officer, director or stockholder of the Company may become pecuniarily interested in any property or matters which are or may become the subject of this agreement, and may contract with the Committee with reference to any of the said matters, the Depositing Bondholders hereby consenting thereto.

V.

The Committee may limit or extend the time within which bonds may be deposited under this agreement, and no bondholder failing to deposit his bonds within the time limited by the Committee, shall have any right to become a party to this agreement without the express written consent of the Committee. Neither the Committee nor any of its members shall be personally liable for any act or omission of any counsel, attorney or agent selected in good faith, nor for any error of judgment, nor mistake of fact or law, nor upon any agreement, note or other instrument signed or entered into by the Committee or authorized by it. No member of the Committee shall be liable for the act or acts, default or defaults, of any other member, nor for anything but his own individual wilful misconduct. The Committee shall not be under any obligation, legal or equitable, expressed or implied, to any bondholder who shall not deposit his bonds hereunder, or to any other person whomsoever other than the holders of the Certificates of Deposit issued in accordance with the terms hereof.

VI.

The Committee shall have the power

(a) to adopt or approve any plan for the readjustment of the property of the Company covered by said deed of trust with or without foreclosure and sale, or for the continuance of the existing bonds and security with any alteration or modification thereof accepted by the Committee, and to change or modify or add to or eliminate any of the provisions of the trust indenture securing said bonds. Any such plan may provide for the acquisition of other property; for the organization of a new corporation or corporations; for the issue and distribution of shares of stocks, bonds, securities, notes and/or other personal property, and for the raising of any sums in cash deemed necessary by the Committee.

(b) To exchange said bonds for other obligations of the Company similar or dissimilar to said bonds and in accordance with or separate from any plan of reorganization which the Committee may hereafter, on behalf of the Depositing Bondholder, approve or adopt; to cancel and acknowledge payment of said bonds and/or authorize the Trustee under said Indenture to reconvey the property thereby conveyed to it upon such terms and for such considerations as the Committee may deem proper, including specifically therein the execution of a new obligation or obligations and the conveyance of any property to the Trustee under a new, amended or different Indenture, mortgage or deed of trust;

(c) To make, execute, enter into, assent to and deliver any and all instruments and documents including conveyance, reconveyances, agreements and subscriptions for bonds which may be necessary or desirable in the opinion of the Committee to accomplish, carry out and complete the provisions of this agreement and to protect the rights of the Depositing Bondholders and the security in the hands of the Trustee for the performance of the Company's obligations;

(d) To designate and appoint one or more depositaries and/or escrow-holders for convenience in the performance of the provisions

of this agreement, and to instruct and authorize said depositaries, and/or escrow-holders to act and perform in their respective capacities, to such extent as the Committee may deem necessary;

(e) To receive sums of money from the Company, or otherwise, for or on account of the obligations due to the Depositing Bondholders, and to disburse, distribute and otherwise deal in and with any and all sums so received in such manner as the Committee may deem most desirable for the protection of the interests of the Depositing Bondholders hereunder; to receive from the Trustee and to give acquittance for any money or property received or held by the Trustee under the provisions of said Indenture and to generally deal in and with any such money or property;

(f) To cause corporations to be formed under such laws and upon such plans and with such powers as the Committee may deem advisable; to cause said corporations to take such proceedings as may be in the opinion of the Committee requisite or desirable, and to represent the Depositing Bondholders in the formation and organization of said corporations and in the performance of their respective corporate functions, including the issuance of shares of stock, bonds, securities, notes and/or personal property thereby, all in order to accomplish, carry out and complete the terms of this agreement;

(g) To employ such agents, attorneys, accountants or advisors as may be necessary in connection with the transactions herein outlined and the performance of the provisions of this agreement, and to pay such compensation as the Committee may deem reasonable to any such person, firms or corporations so employed.

VII.

Upon the completion of any sale, readjustment, reorganization or other arrangement which the Committee considers to be the final accomplishment of the purpose of this agreement, or upon the termination of this agreement, the Committee shall hold all the resultant cash, securities, assets and property (subject to the payment of the expenses and liabilities of the Committee) to distribute the same among the Depositing Bondholders pro rata on the principal amount of their bonds deposited hereunder and for the purpose of such distribution the Committee shall have a discretionary power to sell all or any of the said securities, assets and property.

VIII.

For the purpose of borrowing or raising any moneys, in the judgment of the Committee, required by it, or of furnishing indemnity to the Trustee, or of furthering any of the trusts hereby created, the Committee is hereby authorized and empowered to pledge, mortgage, hypothecate, or assign all or any of the deposited bonds and/or coupons, securities and any other property, real or personal, which may come into the possession or control of the Committee, with such provisions in the loan or indemnity agreement as the lender of the money or the trustee may exact and the Committee shall approve.

IX.

The Depositing Bondholders shall not be personally liable to the Committee, or to any other person, persons, or corporations, for any sum of money or for or in respect of any acts of the Committee, but the Committee and/or the Depositary shall have a first lien (subject however to any lien or liens thereon created by the Committee) upon the deposited bonds and/or coupons and all other securities and property, real or personal, acquired by it, for the reimbursement of all expenses, fees, indebtedness and/or liability incurred by or payable to either of them in acting under this agreement, and said lien shall not be dependent upon possession of said bonds or coupons or other property by the Committee, or the Depositary, who may enforce such lien by a sale, either public or private, of all or any of the property subject thereto, whether real or personal, and without demand upon or notice to any of the depositing bondholders, or any other person or persons whomsoever.

X.

The Committee may, in its discretion, act by or through agents, attorneys or legal counsel.

XI.

If for any reason the Committee shall consider it expedient at any time to terminate this agreement, it may do so by giving notice thereof through the mails registered and postage prepaid, to the holders of Certificates of Deposit, at the addresses of the said holders filed with the Depositary provided, however, that this agreement and any trust created hereby shall in any event cease and terminate as of July 1, 1936. In the event of such termination of this agreement prior to a sale or other disposition of the deposited bonds and/or coupons, the holders of the Certificates of Deposit shall surrender to the Depositary their said certificates properly endorsed in blank, and shall thereupon be entitled to the delivery of the bonds and/or coupons severally deposited by them upon payment pro rata of all expenses, indebtedness and/or liabilities of the Committee, provided, however, that if the Depositary shall have previously delivered any of such bonds and/or coupons to the Committee, it shall not be liable to the depositor for the delivery of such bonds and/or coupons.

XII.

The Depositary shall deliver said bonds and coupons, or any thereof, to the Committee on order of the Committee and the receipt of the Committee shall be a sufficient acquittance therefor to said Depositary. The Depositary shall hold and deal with the deposited bonds and coupons subject to and in accordance with the orders of the Committee and shall be entitled to receive reasonable compensation for its services hereunder. The depositary shall not incur any liability for anything done or permitted to be done at the request or direction of the Committee and shall not be liable for the acts of any agent selected in good faith, nor for anything except its own wilful misconduct. The Depositary shall not be liable for any action taken in good faith in the belief that the depositor of any bond or coupons is the lawful owner and holder thereof or of the certificate of deposit representing the same. The Depositary shall be bound only to exercise reasonable care in the safekeeping of the deposited bonds, coupons, certificates of deposit, and other securities and property which may be deposited with or held by it hereunder and to deal therewith in accordance with the directions of the Committee. The Depositary may resign by giving written notice of such resignation to the Committee at least ten (10) days before such resignation becomes effective. The Depositary may at any time be removed by the Committee and upon such removal the Committee shall have power to appoint a new Depositary hereunder. In the event of any such resignation or removal the Depositary shall, upon receiving due and proper receipt and acquittance and payment of all sums due it hereunder, deliver all cash, securities, property and records held by it to the new Depositary.

XIII.

A writing signed by a majority of the Committee then in office, or a resolution certified by the Secretary of the said Committee, or any member thereof, to have been adopted by a majority of the Committee then in office, a copy of which shall be sufficient evidence

among the Depositing Bondholders pro rata to the principal amount of their bonds deposited hereunder and for the purpose of such distribution the Committee shall have a discretionary power to sell all or any of the said securities, assets and property.

VIII.

For the purpose of borrowing or raising any moneys, in the judgment of the Committee, required by it, or of furnishing indemnity to the Trustee, or of furthering any of the trusts hereby created, the Committee is hereby authorized and empowered to pledge, mortgage, hypothecate, or assign all or any of the deposited bonds and/or coupons, securities and any other property, real or personal, which may come into the possession or control of the Committee, with such provisions in the loan or indemnity agreement as the lender of the money or the trustee may exact and the Committee shall approve.

IX.

The Depositing Bondholders shall not be personally liable to the Committee, or to any other person, persons, or corporations, for any sum of money or for or in respect of any acts of the Committee, but the Committee and/or the Depositary shall have a first lien (subject however to any lien or liens thereon created by the Committee) upon the deposited bonds and/or coupons and all other securities and property, real or personal, acquired by it, for the reimbursement of all expenses, fees, indebtedness and/or liability incurred by or payable to either of them in acting under this agreement, and said lien shall not be dependent upon possession of said bonds or coupons or other property by the Committee, or the Depositary, who may enforce such lien by a sale, either public or private, of all or any of the property subject thereto, whether real or personal, and without demand upon or notice to any of the depositing bondholders, or any other person or persons whomsoever.

X.

The Committee may, in its discretion, act by or through agents, attorneys or legal counsel.

XI.

If for any reason the Committee shall consider it expedient at any time to terminate this agreement, it may do so by giving notice thereof through the mails registered and postage prepaid, to the holders of Certificates of Deposit, at the addresses of the said holders filed with the Depositary provided, however, that this agreement and any trust created hereby shall in any event cease and terminate as of July 1, 1936. In the event of such termination of this agreement prior to a sale or other disposition of the deposited bonds and/or coupons, the holders of the Certificates of Deposit shall surrender to the Depositary their said certificates properly endorsed in blank, and shall thereupon be entitled to the delivery of the bonds and/or coupons severally deposited by them upon payment pro rata of all expenses, indebtedness and/or liabilities of the Committee, provided, however, that if the Depositary shall have previously delivered any of such bonds and/or coupons to the Committee, it shall not be liable to the depositor for the delivery of such bonds and/or coupons.

XII.

The Depositary shall deliver said bonds and coupons, or any thereof, to the Committee on order of the Committee and the receipt of the Committee shall be a sufficient acquittance therefor to said Depositary. The Depositary shall hold and deal with the deposited bonds and/or coupons subject to and in accordance with the orders of the Committee and shall be entitled to receive reasonable compensation for its services hereunder. The depositary shall not incur any liability for anything done or permitted to be done at the request or direction of the Committee and shall not be liable for the acts of any agent selected in good faith, nor for anything except its own wilful misconduct. The Depositary shall not be liable for any action taken in good faith in the belief that the depositor of any bond or coupons is the lawful owner and holder thereof or of the certificate of deposit representing the same. The Depositary shall be bound only to exercise reasonable care in the safekeeping of the deposited bonds, coupons, certificates of deposit, and other securities and property which may be deposited with or held by it hereunder and to deal therewith in accordance with the directions of the Committee. The Depositary may resign by giving written notice of such resignation to the Committee at least ten (10) days before such resignation becomes effective. The Depositary may at any time be removed by the Committee and upon such removal the Committee shall have power to appoint a new Depositary hereunder. In the event of any such resignation or removal the Depositary shall, upon receiving due and proper receipt and acquittance and payment of all sums due it hereunder, deliver all cash, securities, property and records held by it to the new Depositary.

XIII.

A writing signed by a majority of the Committee then in office, or a resolution certified by the Secretary of the said Committee, or any member thereof, to have been adopted by a majority of the Committee then in office at any meeting thereof shall be sufficient evidence of any facts, or of any action of the Committee stated therein, to the Depositary and as against all parties in interest.

XIV.

Any member of the Committee may at any time resign by filing a written resignation with the said Committee and said resignation shall take effect in accordance with its terms.

The Committee shall organize and continue its organization during the period that it shall function under the provisions of this agreement by choosing a Chairman who shall be a member of the Committee and a Secretary who need not be a member of the Committee. Meetings of the Committee shall be held at the office of the Los Angeles Investment Securities Corporation, 1035 South Broadway, Los Angeles, California, or at such other place as may be consented to in writing or by telegraph by all of the members of the Committee, or at which all the members of the Committee may be present and meet as the Committee. At least three days written notice shall be given of any meeting of the Committee which notice may be given by the Chairman or Secretary depositing the same in the United States mail at Los Angeles, California, postage prepaid thereon and addressed to the members of the Committee at their respective addresses as filed with the Committee, provided, however, that no notice need be given of any meeting held by written or telegraphic consent of the members of the Committee or at which all of said members are present regardless of the time or place of the holding thereof. Any two (2) members of the Committee may and must act jointly in all matters and proceedings to be taken, had or done under the provisions hereof. In case at any time a vacancy shall occur in the membership of the Committee such vacancy shall be filled as follows: With reference to any vacancy created by the resignation, death or otherwise of A. R. LeRoy, or any of his successors

California, or its successor. With reference to any vacancy created by the resignation, death or otherwise of Ralph D. Lacoe, Jr. or any of his successors on said Committee, then such vacancy shall be filled by an appointee of Ralph D. Lacoe & Co., San Diego, California, or its successor. With reference to any vacancy created by the resignation, death or otherwise of E. A. Grumm, or any of his successors on said Committee, then such vacancy shall be filled by an appointee of the G. Brashear & Co., Los Angeles, California, or its successor.

Each such successor shall have and exercise all the powers and authorities under this agreement previously possessed by the person in whose place he shall be appointed, to the same extent and effect as if he were herein named as one of the Committee. The Committee, as at any time constituted and notwithstanding any vacancy, shall have all the title, powers, rights and interests of the Committee as originally formed, and in case of the filling of any such vacancy by such appointment, the Secretary of the Committee shall forthwith notify the Depositary of such appointment and shall certify that such appointment was regularly made. The action of a majority of the members of the Committee then in office, either at a meeting or in writing without a meeting, shall be deemed to be the action of the Committee and shall have the same force and effect as if concurred in by each of the original members of the Committee.

XV.

Any member of the Committee may, by a writing filed with the Committee, designate an alternative or proxy, and may at any time by like writing so filed, revoke any such designation and/or designate other alternative or proxy, and each alternative or proxy so designated shall have power and be permitted to act as a member of the Committee in the place and during the absence of the member making such designation, and either in his own name or in the name of such member; and all acts done, consents given and/or signatures made, by such alternative or proxy, shall have the same force and effect as if done, given and/or made by the member designating him as such alternative or proxy.

XVI.

The members of the Committee shall, and they hereby agree to serve without compensation, but this shall not be deemed to exclude the employment and compensation of a member of the Committee as legal counsel.

XVII.

Nothing in this agreement, express or implied, is intended or shall be construed to confer upon or to give to any person or corporations other than bondholders becoming parties hereto and depositing their bonds and/or coupons hereunder, any right or claim under or by reason of this agreement, and all stipulations and promises in this agreement contained, by or on behalf of the Committee, are and shall be held to be for the sole and exclusive benefit of the said parties hereto. The power and authority granted herein by the Depositing Bondholder to the Committee shall be irrevocable, and the Depositing Bondholder shall have no right, power or authority after the execution of this agreement to vary, alter, limit, or restrict the powers of the Committee in any manner or to any extent whatsoever unless and until the authority herein granted shall have terminated by the effect of the limitations and conditions herein specifically set forth.

XVIII.

The receipt of any cash, securities or other property, or certificates of interest therein, distributed by the Committee under any of the provisions of this agreement, and the surrender of his Certificate of Deposit by any Depositor, shall constitute a release and discharge of the Committee and of the Depositary by such Depositor from all liability and accountability of every kind, character and description whatsoever. The receipt by the holders of Certificates of Deposit representing a majority in amount of deposited bonds, of any cash, securities or other property or certificates of interest therein, distributed by the Committee under any of the provisions of this agreement, and the surrender of certificates of deposit representing a majority in amount of the deposited bonds shall constitute a release and discharge of the Committee and of the Depositary on the part of the holders of all outstanding Certificates of Deposit from all liability and accountability of every kind, character and description whatsoever, save the obligation to make delivery of a like pro rata amount of such securities, or other property or certificates of interest therein upon the surrender of outstanding certificates of deposit.

XIX.

The Committee shall have the right and power to levy and collect assessments against the depositing bondholders proportionately with the amount of the bonds deposited hereunder, from time to time and in such sums and amounts as the Committee deem advisable for the proper protection of the bondholders and the rights and interests of the bondholders. Any money so paid in by a depositing bondholder shall be repaid to the bondholders respectively who shall have paid said assessments, together with interest thereon at the rate of Six Per Cent (6%) per annum from the date of payment of said assessments, before any payment or distribution shall be made to bondholders who shall be entitled to distribution of bonds, property or proceeds in the hands of the Committee at the time of termination of this agreement, or prior thereto if partial distribution is to be made. And the Committee shall have full right and authority to sell any property of any kind in its possession in order to realize sufficient moneys to repay the bondholders who shall have paid said assessments.

XX.

The failure of any bondholder owning any bonds and/or coupons hereunder to deliver said bonds and/or coupons to the depositary shall not affect the right of the Committee to proceed to accomplish and carry out the provisions of this agreement in so far as it is able to do by the Depositing Bondholders, it being the intent and purpose hereof that the obligations and delegations of duties herein contained are several as to each of the Depositing Bondholders and not joint on the part of all or any portion of the Bondholders of the Company.

XXI.

Copies of this agreement, signed by each member of the Committee, shall be lodged with the Depositary. This agreement shall become effective when signed by a majority of the members of the Committee. This agreement, however, may be executed in any number

INCORPORATED UNDER THE LAWS OF THE STATE OF CALIFORNIA, 1924

NUMBER 206

SHARES 0

PALM SPRINGS HOLDING CORPORATION

CAPITAL STOCK 10,500 SHARES

3,000 SHARES PREFERRED STOCK
$100 PAR VALUE

7,500 SHARES COMMON STOCK
NO PAR VALUE

SAMPLE

PREFERRED

THIS CERTIFIES that _____ *is the owner of*

_____ *shares of the Preferred Capital Stock of PALM SPRINGS HOLDING CORPORATION transferable only on the books of the Corporation by the holder thereof in person or by Attorney, upon surrender of this Certificate properly endorsed.*

The preferences, privileges and restrictions granted to or imposed upon the respective classes of shares and the holders thereof are as follows:

The holders of record of the preferred shares shall be entitled to receive for any calendar year, when and as declared by the board of directors of the corporation, from the surplus or net profits earned during such calendar year, dividends at the rate of six per cent (6%) per annum, of the par value of such shares, and no more, payable yearly, half yearly or quarterly as the board of directors from time to time may determine. The right to such dividends on preferred shares shall not be cumulative and no right shall accrue to the holders of preferred shares by reason of the fact that dividends on said shares are not declared or paid in any calendar year, but that all payment of all amounts payable during such calendar year on account of fixed charges, taxes, insurance, repairs, general upkeep, reserves, operating expenses, charges, interest, sinking fund and/or principal of any and all debts and/or liabilities of the corporation, after the deduction for depreciation in the sum of fifteen thousand dollars ($15,000) any net profits of the corporation earned during such calendar year remain, it shall be the duty of the directors to declare and cause to be paid to the holders of record of preferred shares, dividends in an amount equal to the aggregate amount of such net profits, but in no event in an amount in excess of the amount equal to six per cent (6%) of the par value of such shares, which dividends shall be payable yearly, half-yearly or quarterly as the directors may determine. No dividends shall be paid upon any of the common shares for any calendar year out of the surplus or net profits earned during such calendar year, unless all dividends thereon declared for the preferred shares previously accrued shall be paid. Upon any liquidation or dissolution or winding-up of the corporation, the holders of the preferred shares shall be entitled to be paid out of the assets of the corporation or the proceeds thereof, before any amount shall be paid to the holders of the common shares, an amount equal to the par value of said preferred shares, whether such liquidation or dissolution or winding-up be voluntary or involuntary, and in addition an amount equal to the aggregate amount of all unpaid dividends declared thereon. Upon such notice to the record owners of the preferred shares as may be provided for by the directors, the corporation, at its election, expressed by resolution of the board of directors, may redeem all or any of the preferred shares, by lot or otherwise as the directors may determine, at the time specified in the resolution of the directors and in such notice, at a price (herein called the "redemption price") equal to one hundred six per cent (106%) of the par value thereof, and in addition an amount equal to the aggregate amount of all unpaid dividends declared thereon, all by such method as shall be provided from time to time by resolution of the board of directors of the corporation. From and after the date fixed in any such notice as the date of redemption, unless default be made by the corporation in providing money at the time and place specified for the payment of the redemption price pursuant to such notice, all dividends on the preferred shares thereby called for redemption shall cease to accrue and all rights of the holders thereof as shareholders of the corporation, except the right to receive the redemption price, shall cease and determine. Every holder of preferred shares of the corporation, by the acceptance of the issuance or transfer of such shares, shall be deemed to confent to the purchase or redemption or retirement of such shares as herein provided.

Except as to the matters and things so stated, no distinction shall exist between said classes of shares or the holders thereof.

IN WITNESS WHEREOF, the duly authorized officers of this Corporation have hereunto subscribed their names and caused the corporate seal to be hereto affixed this _____ *day of* _____, *A. D. 19*____

For value Received hereby sell assign and transfer unto

_____

Shares of the Capital Stock represented by the within Certificate and do hereby irrevocably constitute and appoint _____ Attorney to transfer the said Stock on the Books of the within named Corporation, with full power of Substitution in the premises. Dated _____ 19

In Presence of

_____ _____

NOTICE: THE SIGNATURE TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME AS WRITTEN UPON THE FACE OF THIS CERTIFICATE, IN EVERY PARTICULAR WITHOUT ALTERATION OR ENLARGEMENT OR ANY CHANGE WHATSOEVER.

INCORPORATED UNDER
THE LAWS OF

NUMBER
215

PALM SPRINGS HOLI

CAPITAL STOCK

3,000 SHARES PREFERRED STOCK
$100 PAR VALUE

*THIS CERTIFIES that*_____ *Shares of the*

transferable only on the books of the Corporation by the holder thereof in

The preferences, privileges, and restrictions granted to or imposed upon the respective

The holders of record of the preferred shares shall be entitled to receive for any cal
or net profits earned during such calendar year, dividends at the rate of six per cent (6%)
as the board of directors from time to time may determine. The right to such dividends on pre
by reason of the fact that dividends on such shares are not declared in prior years. In
such calendar year on account of fixed charges, taxes, insurance, repairs, renewals, re
all debts and/or liabilities of the corporation, and after the declaration of dividends in
calendar year remain. It shall be the duty of the directors to declare and pay
amount of such net profits, but in no event in an amount in excess of an amount
yearly or quarterly as the directors may determine. No dividends shall be paid
calendar year, unless all dividends *theretofore* declared upon preferred shares
tion, the holders of the preferred shares shall be entitled to be paid out of the assets of the cor
shares, an amount equal to the par value of said preferred shares, whether such liquidation or
the aggregate amount of all unpaid dividends declared thereon. Upon such notice to the record
election, expressed by resolution of the board of directors, may redeem all or any of the pre
resolution of the directors and in such notice, at a price (herein called the "redemption price")
equal to the aggregate amount of all unpaid dividends declared thereon, all by such method as
From and after the date fixed in any such notice as the date of redemption, unless default be
of the redemption price pursuant to such notice, all dividends on the preferred shares thereby
of the corporation, except the right to receive the redemption price, shall cease and determine,
transfer of such shares, shall be deemed to consent to the purchase or redemption or retirement

Except as to the matters and things as stated, no distinction shall exist between said

IN WITNESS WHEREOF, the duly authorized officers of this Corp

For value Received hereby sell, assign and transfer unto

Shares of the Capital Stock represented by the within Certificate and do hereby irrevocably constitute and appoint Attorney to transfer the said Stock on the Books of the within named Corporation, with full power of substitution in the premises. Dated 19

In Presence of

NOTICE. THE SIGNATURE TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME AS WRITTEN UPON THE FACE OF THIS CERTIFICATE IN EVERY PARTICULAR WITHOUT ALTERATION OR ENLARGEMENT OR ANY CHANGE WHATEVER

Bondholders' Protective Committee

PALM SPRINGS HOTEL COMPANY

First Mortgage 7% Sinking Fund Gold Bonds

1037 SOUTH BROADWAY

LOS ANGELES, CALIFORNIA

March 3, 1932.

TO THE HOLDERS OF FIRST MORTGAGE BONDS PALM SPRINGS HOTEL COMPANY:

The undersigned committee, under the provisions of that certain Deposit Agreement, dated August 20, 1931, covering the First Mortgage Seven Per Cent. Sinking Fund Gold Bonds of Palm Springs Hotel Company, has, for the past several months, been engaged in making a survey of the condition of the company and of this property; and in working out a plan for the best interests of the bondholders.

The El Mirador Hotel property at Palm Springs, California, is owned by the Palm Springs Hotel Company and is operated by the El Mirador Hotel Operating Company, Ltd., under a lease executed in May, 1927. The total amount heretofore invested in the project is in excess of $900,000.00. Of this sum, $309,000.00 is represented by bonds now issued and outstanding; in addition there are certain obligations on account of a sprinkler contract, lease contracts, taxes and other charges totaling about $60,000.00, as hereinafter more definitely described, which must now be taken care of. The balance of the invested capital is represented by second mortgages, unsecured debts, and the amount originally paid in by stockholders, plus stockholders' advances and assessments.

Your committee is of the opinion that the stockholders of the two hotel companies have done everything within their power to carry on and that they can do no more. They have, during the past three years, put large sums of money into the undertaking; all of which, together with their original investment, is apparently lost.

The hotel was constructed in the summer and fall of 1927, at which time construction costs, as well as the cost of furnishings, were greatly in excess of those of today. In addition, actual depreciation over the five years has been very large. The cost of new furnishings, of the type now in the hotel, is about one-half of the original purchase price; and depreciation thereon is always heavy, particularly in a desert climate.

Owing to the fact that there were not a sufficient number of bonds deposited with the committee prior to November 1, 1931, in order to enable the committee to take any concerted action before it was necessary to open the hotel for this winter season, your committee, in cooperation with the hotel companies and with R. D. Lacoe, Sr., worked out a plan for operations this year. It was determined by all interested parties that the hotel must be kept open this season and operated as a going concern. This was very important, particularly to the bondholders. If the hotel had remained closed, not only would a valuable good-will have been lost, thus causing an unwarranted depreciation in the value of the whole project, but there would also have been considerable expense in caring for the vacant buildings and grounds.

At present there are deposited with your committee, bonds of a face value of $172,000.00. In

that must be taken care of in order to preserve the asset value of the property. Of such obligations, there are (a) the sprinkler system contract, which was originally $40,000.00, and upon which approximately $13,500.00 remains unpaid; (b) certain lease or purchase contracts, having an unpaid balance of only $11,500.00 and covering furnishings with a value much in excess of the balance due; (c) accrued and unpaid taxes as of April 1, 1932, exceeding $15,000.00; (d) the expenses during the summer months of watchman, caretakers and gardeners, in addition to normal expenses for water, electricity, taxes and insurance; (e) large fees, costs and expenses in the event of foreclosure and/or purchase, and in any event the expenses and costs of reorganization and/or acquisition; (f) about $10,000.00 for working capital to begin operations for the coming season.

In addition to the foregoing, your committee is convinced that it will be necessary to expend a large sum to place the property, furnishings and equipment in a satisfactory operating condition. In order that we might have all of the facts, Mr. Clyde Mowder, the supervising engineer of the Los Angeles Investment Company, made a visit to the property for the purpose of ascertaining requirements. After consulting with Mr. Mowder, with the present operators of the hotel and with others, we have come to the conclusion that it is not only advisable but really a necessity that approximately $90,000.00 be expended in making vital repairs, changes and improvements. Therefore, the total of the obligations of the company which, either technically or in practical effect, are prior to or on a par with the bonds, and the cost of the repairs and improvements which are deemed absolutely essential, is $150,000.00.

PLAN OF REORGANIZATION

Subject to the approval of the State Corporation Department, we propose that a corporation be organized, with an authorized Six Per Cent. Non-Assessable, Non-Cumulative, Preferred Stock of $300,000.00, of the par value of $100.00 per share, callable at par and an authorized Common Stock of 7500 shares, of no par value. This corporation would acquire the bonds of those depositing bondholders who approve this plan, and of R. D. Lacoe, Sr., and his associates, and such of the few non-deposited bonds as it could secure. Upon such acquisition, the corporation would institute the necessary proceedings and/or take the necessary steps for the acquisition and/or sale, by foreclosure or otherwise, of all of the bonds, hotel property, furnishings and good-will, free of any claims whatsoever except those charges in the estimated amount of $60,000.00, which must be provided for as hereinabove indicated. Mr. R. F. Ingold or other representative of the assenting bondholders will be on the board of directors of the new corporation.

In order to take care of these obligations, and also to raise the necessary funds for changes, repairs and improvements, it is proposed that this new corporation create an issue, as a prior lien against the property, of $150,000.00 in First Mortgage Seven Per Cent. Bonds.

There will be issued to each present owner of a $1000.00 bond, ten shares of Six Per Cent. Non-Cumulative Preferred Stock, and one $500.00 Seven Per Cent. Bond of the new issue, for each $1000.00 bond of the old issue, and the payment by such bondholder into the corporation's treasury of $500.00 in cash. In the event any present bondholder does not desire to purchase additional bonds, then such bondholder, for each $1000.00 bond, shall be entitled to receive six shares of said Preferred Stock and four shares of Common Stock (holders of $500.00 bonds shall be entitled to one-half of the foregoing).

Any bonds not sold to present bondholders under the foregoing plan, may be sold to the public at such price and under such terms and with such bonus of Preferred Stock as your committee and/or the directors of the new corporation may deem necessary or best; provided, however, that if there are not sufficient subscribers to the proposed new bond issue to effect this plan of reorganization, or if for any other reason the

insurance; (e) large fees, costs and expenses in the event of foreclosure and/or purchase, and in any event the expenses and costs of reorganization and/or acquisition; (f) about $10,000.00 for working capital to begin operations for the coming season.

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Any bonds not sold to present bondholders under the foregoing plan, may be sold to the public at such price and under such terms and with such bonus of Preferred Stock as your committee and/or the directors of the new corporation may deem necessary or best; provided, however, that if there are not sufficient subscribers to the proposed new bond issue to effect this plan of reorganization, or if for any other reason the Board of Directors of the new corporation deems it inadvisable to issue said bonds; then and in that event said offer to present bondholders of a participation in the new issue shall be void and of no effect; and said present bondholders shall be entitled to receive only their six shares of Preferred Stock and four shares of Common Stock, as hereinabove provided; likewise the Board of Directors of the corporation is hereby authorized to offer and/or give said bonus of four shares of Preferred Stock or any part thereof per each unit of $1000.00 advanced, to the person lending or advancing said monies and/or the person instrumental in obtaining the same, and such loan may be secured in like manner as the proposed bond issue or otherwise.

Any shares of the authorized Common Stock, remaining unissued under the foregoing, will be issued to R. D. Lacoe, Sr., and/or his order. In consideration whereof, he agrees not only not to oppose the plan herein outlined, but to assist in its fulfillment. He agrees to undertake the voting control and management of the new corporation, and in the event it acquires the property as herein indicated, to cause to be placed in the treasury of the corporation, prior to November 1, 1932, sufficient monies from said sale of bonds and/or Preferred Stock and/or otherwise to meet the requirements indicated in "a" to "f," inclusive, above. Your committee realizes fully that it is not properly equipped to undertake the operation of a resort hotel project at Palm Springs. It realizes, likewise, that it would be extremely difficult, at this time and under existing conditions, to raise money for any hotel project, particularly for a resort hotel with a poor earning record over the past four years, and that it is only fair and proper to give the large bonus of Common Stock to any responsible party whom it feels is capable of carrying on successfully.

Your committee has spent a great deal of time in connection with this matter and is of the unanimous opinion that, under existing conditions, the plan above outlined is for the best interests of the bondholders and affords the best available opportunity for the bondholders to eventually get back all or a substantial proportion of their original investment, and none of the assenting bondholders represented by your committee will be required to furnish additional money at this difficult period to protect the project or to pay any of the costs, expenses, or advances to your committee as the same will be assumed by the new corporation when the plan is consummated.

If this plan is not consummated, seemingly the only other alternative is to proceed with the foreclosure of the Trust Indenture. Inasmuch as your committee has had deposited with it only $172,000.00 face value of bonds, it can readily be seen that, with obligations of about $60,000.00 necessary to be taken care of, it would require a considerable amount of cash to make any substantial bid for the property at the sale and to protect it thereafter. This would entail an immediate large assessment against the depositing bondholders. Furthermore, such procedure might easily result in expensive litigation and such long delays that the hotel could not be open for business next fall.

Your committee is convinced that only with the cooperation of substantially all bondholders will the project be placed in a condition for operations next fall. Furthermore, by agreeing to the foregoing plan, and with the assurance of Mr. R. D. Lacoe, Sr., and his associates that sufficient money will be raised to satisfy the holders of prior obligations, the expenses of foreclosure and or of reorganization, and monies required to open the hotel and operate it next season, the bondholders are assured of the continuance of the project as a going concern.

While under the terms of the deposit agreement, your committee was delegated with authority to enter into any plan of which it approved, nevertheless, in order that no one may be compelled to join in the plan unless satisfied that it is the best plan that can be worked out under existing conditions, your committee will allow any bondholder, who is not satisfied, to withdraw at this time his or her bonds.

Every holder of the old bonds, now on deposit under said deposit agreement, may withdraw his bonds by paying, on or before March 20, 1932, to the said depositary or to the Bondholders' Protective Committee his or her pro rata share of the committee's expenses, advances and obligations, and by presenting his deposit receipts to said depositary and withdrawing deposited bonds at the time of such payment.

It is agreed that the committee may change the above indicated plan in any manner which is finally approved by the board of directors of the corporation and the State Corporation Department, and shall have full power

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the large bonus of Common Stock to any responsible p
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revocably authorized and instructed by all non-
actical operation the above indicated plan in its
ry or advisable; and the committee is hereby
sary or proper to enable it to carry out said plan
nces which it may deem necessary or best. The

committee is hereby vested with legal title to all deposi
Protective Agreement heretofore executed, except as he
adopted.

It is, of course, understood that the plan herein ou
sufficient number of bondholders represented by your
of the details of the plan have not yet been agreed upo
approval of the State Corporation Department.

Your committee heartily recommends and urges th
hereinabove outlined. **There is enclosed herewith for y**
request that you execute and return immediately in or
in effect at the earliest possible moment. Inasmuch as th
legal details taken care of, it is necessary that all possi
the plan.

The foregoing plan of reorganization is hereby a
tion thereof is indicated by the signatures of all of the

ted bonds and all provisions of the Bondholders' rein finally modified, are hereby confirmed and

tlined can only be consummated in the event a committee consent hereto, and further, that all n and that the plan as a whole is subject to the

at each of the bondholders consent to the plan your signature, a consent which we respectfully der that the plan of reorganization may be put e corporation has to be formed, and many other ble time be saved to assure the carrying out of

dopted by said committee, and its recommenda- nembers thereof.

A. R. LE ROY,
E. A. GRUMM,
R. F. INGOLD,
Bondholders' Protective Committee.

[Endorsed]: No. 9661. United States Circuit Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Palm Springs Holding Corporation, Respondent, and Palm Springs Holding Corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the United States Board of Tax Appeals.

Filed October 12, 1940.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

No. 9661

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

PALM SPRINGS HOLDING CORPORATION,
Respondent,

and

PALM SPRINGS HOLDING CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Upon Petitions to Review a Decision of the United States Board of Tax Appeals

PROCEEDINGS HAD IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

PARKER PRINTING COMPANY, 545 SANSOME STREET, SAN FRANCISCO

United States Circuit Court of Appeals for the Ninth Circuit

Excerpt from Proceedings of Monday, March 31, 1941.

Before: Mathews and Stephens, Circuit Judges and Hollzer, District Judge.

[Title of Cause.]

ORDER OF SUBMISSION

Ordered petitions to review herein argued by Mr. L. W. Post, Special Assistant to the Attorney General, counsel for the Commissioner, and by Mr. Frank Mergenthaler, counsel for taxpayer, and submitted to the Court for consideration and decision.

United States Circuit Court of Appeals for the Ninth Circuit

Excerpt from Proceedings of Wednesday, May 14, 1941.

Before: Denman, Mathews and Healy, Circuit Judges.

[Title of Cause.]

ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT.

By direction of the Court, Ordered that the typewritten opinion this day rendered by this court in

above cause be forthwith filed by the clerk, and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion rendered.

[Title of Circuit Court of Appeals and Cause.]

PETITIONS TO REVIEW A DECISION OF THE UNITED STATES BOARD OF TAX APPEALS.

Before Mathews and Stephens, Circuit Judges, and Hollzer, District Judge:

Mathews, Circuit Judge:

These are petitions to review a decision of the Board of Tax Appeals redetermining claimed deficiencies in respect of income and excess profits taxes of Palm Springs Holding Corporation (hereafter called the taxpayer) for the taxable year ended May 31, 1936.

In May, 1932, the taxpayer acquired bonds of Palm Springs Hotel Company, a corporation (hereafter called the Hotel Company), of the face value of $292,000. The bonds were secured (1) by a mortgage on real property owned by the Hotel Company and leased by it to Palm Springs Hotel Operating Company,[1] a corporation (hereafter called the Operating Company), and (2) by a pledge of the lease and a chattel mortgage securing performance of the Operating Company's obligations

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1. Later known as El Mirador Hotel Operating Company.

thereunder, the chattel mortgage being on furniture and fixtures owned by the Operating Company. Both the realty mortgage and the pledge were to California Trust Company, as trustee.

On July 15, 1932, the bonds being in default, the mortgaged realty and the pledged lease and chattel mortgage were sold by the trustee and purchased by the taxpayer for a bid price of $61,800, of which $18,767.96 was paid in cash, the balance ($43,032.04) by the taxpayer's surrendering its Hotel Company bonds to the trustee. Thereafter the taxpayer foreclosed the chattel mortgage and, at the foreclosure sale, August 2, 1932, purchased the mortgaged furniture and fixtures for a bid price of $20,179.25.

All the property mentioned—the real property purchased on July 15, 1932, and the personal property (furniture and fixtures) purchased on August 2, 1932—was used by the taxpayer in its trade or business in the taxable year ended May 31, 1936. Hence the taxpayer, in computing its net income for the taxable year, was entitled to an allowance for depreciation of the property. Revenue Act of 1934,[2] § 23 (1).

This the Commissioner of Internal Revenue conceded, but he and the taxpayer did not agree as to the basis on which such depreciation should be determined. The taxpayer contended that the basis of the real property was the same as it would have been in the hands of the Hotel Company, with ad-

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2. Act of May 10, 1934, c. 277, 48 Stat. 680-772.

justments as provided in § 113(b) of the Revenue Act of 1934, and that the basis of the personal property was the same as it would have been in the hands of the Operating Company, with similar adjustments. The Commissioner contended that the basis of all the property was the cost thereof to the taxpayer, with adjustments as provided in § 113(b). With respect to the real property, the Board agreed with the taxpayer. With respect to the personal property, it agreed with the Commissioner. Both parties have petitioned for review.

Section 114(a) of the Revenue Act of 1934 provides that, with inapplicable exceptions, the basis on which depreciation is to be allowed in respect of any property shall be "the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property." Section 113(b) provides that the adjusted basis for determining such gain shall be the basis determined under § 113(a), with specified adjustments. Section 113(a) provides that, with specified exceptions, "the basis of property shall be the cost of such property." Of the fourteen exceptions specified in § 113(a), the only one which could possibly be regarded as applicable here is the one specified in § 113(a)(12), which provides:

"If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purposes of the Revenue Act of 1932,[3] was prescribed

3. Act of June 6, 1932, c. 209, 47 Stat. 169-289.

by section 113(a)(6), (7), or (9) of such Act, then for the purposes of this act the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932."

The property here involved was acquired after February 28, 1913, in a taxable year beginning prior to January 1, 1934. The taxpayer, however, does not contend that the basis of the property was that described in § 113(a)(6) or § 113(a)(9) of the Revenue Act of 1932. Its contention is that the basis of the property was that prescribed in § 113 (a)(7) of the Revenue Act of 1934,[4] which is identical with § 113(a)(7) of the Revenue Act of 1932, which provides:

"If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made . . . "

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4. In support of its contention that the basis of the property was that prescribed in § 113(a)(7), the taxpayer cites both § 113(a)(6) and § 113(a)(7) of the Revenue Act of 1934, being apparently under the delusion that both prescribe the same basis. Actually, they prescribe different bases. Thus, if applicable, § 113(a)(6), instead of supporting the taxpayer's contention, would require its rejection.

That the property here involved was acquired after December 31, 1917, by a corporation (the taxpayer) is conceded. Questions to be decided are (1) whether the property was acquired in connection with a reorganization and (2) whether immediately after the transfer an interest or control in the property of 50 per centum or more remained in the same persons or any of them.

Section 112(i) of the Revenue Act of 1932 defines the term "reorganization" as "(A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected."[5]

The taxpayer does not contend that any of the property here involved was acquired in connection with any transaction mentioned in subdivision (B), (C) or (D) of § 112(i). Its contention is that the property was acquired in connection with a merger

5. With later definitions—found in § 112(g) of the Revenue Acts of 1934, 1936 and 1938 and § 112(g) of the Internal Revenue Code—we are not here concerned.

or consolidation mentioned in subdivision (A), namely, the acquisition by one corporation (the taxpayer) of substantially all the properties of two other corporations (the Hotel Company and the Operating Company). Thus, it is contended, the property was acquired in connection with a reorganization within the meaning of § 112 (i).

The real property and other property acquired by the taxpayer at the trustee's sale on July 15, 1932, constituted all the property of the Hotel Company. The personal property acquired by the taxpayer at the foreclosure sale on August 2, 1932, constituted all the property of the Operating Company. It does not, however, necessarily follow that these acquisitions or either of them constituted a merger or consolidation—and hence a reorganization—within the meaning of § 112 (i).

It should here be recalled that the taxpayer paid for the real property partly in money, partly in bonds of the Hotel Company, and paid for the personal property in money. Neither the Hotel Company nor the Operating Company got anything for its property except the satisfaction or partial satisfaction of certain indebtedness. Neither received any stock or bonds of the taxpayer. Neither retained any stake or proprietary interest in the corporate enterprise in which theretofore it had engaged. Hence, the transactions whereby the taxpayer acquired the property were mere sales or exchanges. Neither amounted to a reorganization. Pinellas Ice & Cold Storage Co. v. Commissioner,

287 U. S. 462, 468-470; LeTulle v. Scofield, 308 U. S. 415, 419-421; Helvering v. Tyng, 308 U. S. 527; Commissioner v. Bondholders Committee, 9 Cir., ... F. 2d ....., decided March 8, 1941.

The contrary view derives no support from Commissioner v. Kitselman, 7 Cir., 89 F. 2d 458, or from Newberry Lumber & Chemical Co. v. Commissioner, 6 Cir., 94 F. 2d 447. For the Kitselman and Newberry cases, so far as relevant here, were in effect overruled by LeTulle v. Scofield and Helvering v. Tyng, supra. In Commissioner v. Southwest Consolidated Corp., 5 Cir., ... F. 2d....., cited by the taxpayer, stock of the transferee was exchanged for stock, as well as bonds, of the transferor, thus permitting the transferor's stockholders to retain a proprietary interest in the corporate enterprise. In the case at bar, the transferors' stockholders got nothing.

We reject also the taxpayer's contention that immediately after the above mentioned transfers an interest or control in the transferred property of 50 per centum or more remained in the same person as before, namely, the taxpayer. For prior to the transfers the taxpayer had no interest or control in any of the property, but was merely a creditor of the owners—the Hotel Company and the Operating Company. And this is true despite the fact that the Hotel Company's debt was evidenced by bonds.

We regard as immaterial the fact, much stressed by the taxpayer, that at the time of the transfers each company had only one stockholder and only

ten shares of stock outstanding. For whether a corporation has one or many stockholders, or ten or ten thousand shares outstanding, the rule is that its stockholders, not its creditors, control and, in effect, own the corporation. The rule is applicable here.

With respect to the personal property involved, the Board held, and properly so, that the basis was not that prescribed in § 113(a)(7), but was the cost of such property to the taxpayer, with adjustments as provided in § 113(b) of the Revenue Act of 1934. That should have been its holding with respect to all the property, real and personal.

Decision reversed and case remanded for further proceedings in conformity with this opinion.

[Endorsed]: Opinion. Filed May 14, 1941. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals
for the Ninth Circuit

No. 9661.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

PALM SPRINGS HOLDING CORPORATION,
Respondent.

PALM SPRINGS HOLDING CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

JUDGMENT

Upon Petitions to Review a Decision of the United States Board of Tax Appeals, This Cause came on to be heard on the Transcript of the Record from the United States Board of Tax Appeals and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the Decision of the said Board of Tax Appeals in this Cause be, and hereby is reversed, and that this cause be, and hereby is remanded to the said Board of Tax Appeals for further proceedings in conformity with the opinion of this court.

[Endorsed]: Filed and entered May 14, 1941. Paul P. O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause.]

CERTIFICATE OF CLERK, U. S. CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT, TO RECORD CERTIFIED UNDER RULE 38 OF THE REVISED RULES OF THE SUPREME COURT OF THE UNITED STATES.

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing ninety-six (96) pages, numbered from and including 1 to and including 96, to be a full, true and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of counsel for the taxpayer, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 30th day of July, A. D. 1941.

[Seal] PAUL P. O'BRIEN,
Clerk.